The Political Economy of FDI in Thailand and its Implications for Sustainable Economic Development

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School of Business
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Declaration of Originality

I certify that this thesis does not incorporate without acknowledgement any material previously submitted for a degree or diploma in any university; and that to the best of my knowledge and belief it does not contain any material previously published or written by another person except where due reference is made in the text.

Signed: ___________________ On: __/__/____
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This thesis is dedicated to my whole family; I hope I have made you proud.
Abstract

This thesis analyses the determinants and consequences of foreign direct investment (FDI) in Thailand, with particular emphasis on reviewing the Thai government’s FDI policies, and these policies’ effectiveness for enabling the country’s sustainable development. Past research has indicated that, despite developing countries’ various attempts to improve their economic growth and increase their standard of living via internationalisation, many of these attempts have proven unsuccessful. In the case of Thailand, there is debate regarding how the government can influence and regulate FDI in a manner that is most beneficial to the country’s long-term growth and development.

It has long been recognised that Thailand’s economic policies are determined in a political environment that is driven mainly by individuals’ and groups’ personal interest. Thus, research on the political process of policy formation is essential to predict future policy directions. This thesis takes a more concentrated approach by examining the effects of FDI on Thailand’s economic growth in the context of the political economy. The main areas examined are: (i) whether FDI has had a positive effect on the Thai economy; (ii) in which sector FDI has been most productive; (iii) whether the Thai government has been successful in achieving improved economic growth through implementing its FDI policies; and (4) if not, which areas have reported failure, what possible alternative policies exist, and what the expectations are for Thailand’s future.

In assessing Thailand’s performance, this study found that the contribution of FDI to gross domestic product and employment growth varies across sectors. Generally, there is room for improvement in all sectors, which can be achieved by addressing the structural weaknesses in Thailand’s financial system and improving the country’s
infrastructure, education and health. Appropriate measures will improve human capital, increase absorptive capacity, and thereby enhance the overall spillover effects of FDI.
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<td>ACIA</td>
<td>ASEAN Comprehensive Investment Agreement</td>
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<td>ACFTA</td>
<td>ASEAN–China Free Trade Area</td>
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<td>AEC</td>
<td>ASEAN Economic Community</td>
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<td>Asian Financial Crisis</td>
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<td>AFTA</td>
<td>ASEAN Free Trade Area</td>
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<td>AIA</td>
<td>ASEAN Investment Area</td>
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<td>ASEAN</td>
<td>Association of Southeast Asian Nations</td>
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<td>BOI</td>
<td>Board of Investment</td>
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<td>Balance of Payments</td>
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<td>Bank of Thailand</td>
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<td>CLMV</td>
<td>Cambodia, Laos PDR, Myanmar and Vietnam</td>
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<td>Electricity Generating Authority of Thailand</td>
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<td>EME</td>
<td>Emerging Market Economy</td>
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<td>Financial Sector Foreign Direct Investment</td>
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<td>Global Competitiveness Report</td>
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<td>GDP</td>
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<td>GNP</td>
<td>Gross National Product</td>
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<td>HAI</td>
<td>Human Achievement Index</td>
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<td>HDI</td>
<td>Human Development Index</td>
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<tr>
<td>HK</td>
<td>Hymer-Kindleberger</td>
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<td>ICT</td>
<td>Information and Communications Technology</td>
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<td>IDP</td>
<td>Investment Development Path</td>
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<td>IEF</td>
<td>Index of Economic Freedom</td>
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<td>IMD</td>
<td>Institute for Management Development</td>
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<td>OLI</td>
<td>Ownership, Location and Internalisation</td>
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<td>PDR</td>
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<td>PISA</td>
<td>Programme for International Student Assessment</td>
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<td>Product Life Cycle</td>
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<td>Strengths, Weaknesses, Opportunities and Threats</td>
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<tr>
<td>TFDI</td>
<td>Tourism Foreign Direct Investment</td>
</tr>
<tr>
<td>TFP</td>
<td>Total Factor Productivity</td>
</tr>
<tr>
<td>UIL</td>
<td>University–Industry Linkage</td>
</tr>
<tr>
<td>UNCTAD</td>
<td>United Nations Conference on Trade and Development</td>
</tr>
<tr>
<td>UNDP</td>
<td>United Nations Development Program</td>
</tr>
<tr>
<td>US</td>
<td>United States</td>
</tr>
<tr>
<td>WDI</td>
<td>World Development Index</td>
</tr>
<tr>
<td>WEF</td>
<td>World Economic Forum</td>
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<td>WTTC</td>
<td>World Travel and Tourism Council</td>
</tr>
</tbody>
</table>
Chapter 1: Introduction

1.1 Introduction

This study examined Thailand’s foreign direct investment (FDI) development and its effects on different sectors of the economy through international trade and finance. The importance of FDI as a part of economic growth has been widely emphasised in both the economic and finance literature, with particular emphasis on the anticipated spillover effects. Fast-growing economies such as China and India have been focusing on FDI as a necessary source of economic growth and development. Specifically, FDI is expected to improve productivity, research and development (R&D), technology and foreign exchange; create more jobs; and increase access to foreign markets. However, FDI’s effects vary between countries, depending on numerous factors—both internal and external. Researchers have also come to expect results to differ significantly among groups of developed countries and developing countries. The simple theoretical relationship in the FDI–growth nexus becomes much more complex when investigating this relationship in an empirical setting. Different approaches have yielded different, and often conflicting, outcomes. Flora and Agrawal (2014) succinctly summarised previous studies that explored the FDI–growth relationship, as presented in Figure 1.1.
Figure 1.1. Empirical literature investigating the FDI–growth nexus. Source: Flora and Agrawal (2014).

It is clear that past empirical evidence has indicated mixed outcomes that are inconclusive. Not only do results vary between countries and across time periods, but they are also largely determined by modifiable estimation techniques, observation, the accuracy of data and many other discrepancies. Before proceeding, it is important to emphasise that this thesis did not attempt to replicate any of these earlier works, or find consensus in this growing field of study. This thesis focused specifically on Thailand, and applied simple estimation techniques in an attempt to obtain results by employing the most reliable and readily available official data.

This chapter introduces an overview of the research background, focusing on the role of FDI as a main driver of growth in Thailand. After discussing the objectives of the research, this chapter provides a brief discussion of the intended research methods. It concludes by discussing this research’s implications and expected contributions to the literature.
1.2 Research Background

Many studies have sought to establish a causal link between FDI and economic growth that might have important implications for economies’ development strategies. Causality between FDI and productivity growth would lend credence to the FDI-led growth hypothesis. If the causal process were in the reverse direction, this would imply that economic growth is a prerequisite for a host country to attract FDI. If the causal process were bidirectional, this would indicate that FDI and growth are interdependent, and a virtuous cycle could subsequently be expected.

Accordingly, vast literature has been dedicated to identifying the FDI–growth nexus. Many empirical studies have indicated that higher economic growth will lead to greater FDI inflows to host countries. Jackson and Markowski (1995) found that economic growth has had a positive effect on FDI inflows in some Asian countries. The studies by Kasibhatla and Sawhney (1996) and Rodrik (1999) in the United States (US) revealed a unidirectional causal relationship from economic growth to FDI. Further, in India, Chakraborty and Basu (2002) employed a Vector Error Correction Model to determine the short-term dynamics of FDI and growth from 1974 to 1996. Their empirical results revealed that causality runs more from real gross domestic product (GDP) to FDI flows. In addition, Tsai (1994) employed a simultaneous system of equations to test two-way linkages between FDI and economic growth for 62 countries from 1975 to 1978, and 51 countries from 1983 to 1986. He found that two-way linkages existed between FDI and growth in the 1980s. Bende-Nabende et al. (2001) also investigated the effect of FDI on the growth of the Association of Southeast Asian Nations (ASEAN) 5 economies for 1970 to 1996, and found a bidirectional relationship between the two variables. Similarly, Liu et al. (2002) in China, Basu et al. (2003) in 23 developing countries, Saha (2005) in 20 Latin America and Caribbean countries,

In contrast, studies by Akinlo (2004) and Ayanwale (2007) in Nigeria, Habiyaremye and Ziesemer (2006) in Sub-Saharan Africa and Duasa (2007) in Malaysia found no evidence of a causal relationship between FDI and economic growth. Herzer (2012) considered the possibility that the growth effect of FDI may depend on the economic significance of the FDI. Herzer observed that many countries record FDI as a share of GDP at less than one per cent, thus FDI might simply be too marginal to have a serious growth effect. This implies that the size of the growth effect of FDI may increase with the economic significance of FDI. Specifically, studies have found that FDI increases growth when host economies’ characteristics point to the existence of an ‘absorptive capacity’. However, what exactly constitutes that absorptive capacity varies. It may be related to countries with a high income level (Blomstrom, Lipsey & Zejan, 1994), an open trade regime (Balasubramanyam et al., 1996), a highly educated workforce (Borensztein et al., 1998) or a well-developed financial market (Alfaro et al., 2004, 2006).

Previous macroeconomic studies have encountered a significant methodological problem arising from the fact that causality may be reversed. To address the potential two-way causality between FDI inflow and economic growth, Kholdy (1995) employed Granger causality tests for a set of developing countries. He found that FDI can be influenced by factor endowments, technological capacities and market size. Moreover, he found that the causality between growth and FDI ran from growth to FDI, and not vice versa.
In summary, there is well established literature examining the causal nexus between FDI and economic growth in emerging economies. However, the results appear to be ambiguous. While the macroeconomic relationship between FDI and economic growth is empirically supported, the direction of causality is unclear, which could be due to the different host economies’ absorptive capacity. Nevertheless, the well-documented benefits of FDI have created the general perception that FDI is one of the most desired growth-enhancing drivers for developing countries. As a result, many governments have focused on attracting FDI in order to climb the economic development ladder and improve their country’s economic status. The most documented benefits of FDI are technological spillover, human capital formation, international trade integration, firm development, development of managerial knowledge, advanced production techniques, an increasing competitive environment, poverty alleviation, increased job opportunities, and increased levels of R&D and innovation. However, increasing dependence on international firms can lead to increased sovereign risk and a loss of political autonomy. Thus, a detailed analysis of the determinants and effects of FDI are crucial for countries that are focused on attracting FDI as their major driver of growth (Benáček et al., 2014).

For Thailand, rich natural resources and low labour costs have previously attracted FDI from countries such as Japan and the US, as reflected in Figure 1.2. However, the real effects of these FDI inflows on Thailand’s economic growth are not clearly visible, and require proper analysis.
In terms of those seeking FDI, international investors are looking for access to natural resources, markets, technology, industry clusters and cost savings. For many years, this has made Thailand one of the preferred ASEAN destinations for foreign investors (Kinghorn, 2011). However, recently, there has been concern regarding FDI inflow for countries such as Thailand and Malaysia, whose investment focus has been built on cheap labour, rich natural resources and a sizable domestic market, and, as a result, they appear to be falling behind their ASEAN competitors. For example, Singapore has advanced with stronger government support and better infrastructure, and has subsequently secured an international reputation as a technology and industry hub for associated industries in medical devices and logistics (Wong & Singh, 2009). In contrast, in developing Asia, including Thailand, there is an apparent weakness in governments’ strategies to attract advanced technologies via FDI. Figure 1.3 demonstrates the outstanding growth of Singapore catching up to China, while Malaysia, Vietnam and Thailand fall behind.
Nevertheless, Thailand’s development strategy has been strongly market-oriented and open to trade and investment flows with the rest of the world since the late 1950s, and has achieved reasonable growth performance over time. In particular, there has been significant improvement during the past decade in the economic wellbeing of Thailand’s population, for factors such as life expectancy, infant and maternal mortality, and literacy. However, there is concern that the performance of the education system remains chronically deficient. Further, environmental problems and institutional failures in resource management have not been completely eliminated. Therefore, reform is needed in several areas, particularly in terms of political and corporate governance, regulation of industry, and education and health systems. Although acknowledged, these persisting problems remain largely ignored by policymakers and bureaucrats. Instead, the government has been more focused on promoting FDI and attracting investors via the formation of the ASEAN and ASEAN Economic Community (AEC). Within these
international bodies, Thailand is seeking to compete with its neighbouring countries to attract FDI, while overlooking investment in potential high-growth sectors, such as the agriculture, education and health industries.

1.3 Thesis Proposition

Given this background, this study investigated past research related to FDI as a vehicle for economic growth in order to examine actual development policies and analyse the determinants and consequences of FDI for growth. The importance of this research is reflected in governments implementing FDI policies that aim to induce positive flows, complementary to the country’s economic conditions. Despite the considerable amount of research undertaken on the topic, Thailand—as a relatively small economy compared to countries such as China—noticeably lacks any comprehensive economic analysis of its FDI experience. This study sought to make up for this deficiency in the literature.

1.4 Research Focus

According to Thailand’s Board of Investment (BOI), Thailand is a fast-growing economy that is moving from agriculture to manufacturing, and towards a knowledge-based economy. In the Economist’s Pocket World in Figures 2015, Thailand is ranked as the world’s 33rd largest economy, 24th largest economy by purchasing power, 27th biggest exporter, and 2nd largest economy in ASEAN (BOI, 2015). In terms of economic output, Thailand has the world’s 12th largest agriculture output, 16th largest manufacturing output, and 35th largest services output (Economist books, 2015). Moreover, Ease of Doing Business 2015 ranked Thailand 26th in the world, and 2nd among emerging economies in East Asia. In addition, in its 2014 World Investment Report, the UNCTAD ranked Thailand the 8th best FDI host economy in the world for

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1 East of Doing Business is The World Bank’s report that measures regulations affecting domestic and medium-sized enterprises covering nine indicators for 189 economies.
2014-2016, while Bloomberg Business ranked Thailand the world’s 11th most promising emerging market (BOI, 2015).

Thailand is clearly moving towards a liberal investment regime, with BOI privileges and measures offering many incentives for selected industries, including various tax incentives, 100 per cent foreign ownership, no restrictions on foreign currency, no export requirements, and no local content requirements (Thai Embassy, 2015). With these liberal actions and progressive ranking from established organisations such as the UNCTAD and World Bank, Thailand already prides itself as a high achiever in attracting FDI. Thus, the focus of this thesis is not on how to attract more FDI, but on how beneficial current FDI inflows are for the domestic economy. There has not been much discussion of how this inward FDI is affecting the country’s economic growth, especially at the sectoral level. This study strongly believes that careful analysis of the effects of FDI should be a priority for the Thai economy in order to achieve a more balanced and sustainable development path.

Previous research has found that the net benefits of FDI and their magnitude differ according to host countries’ developmental policies. Criticisms in particular studies have highlighted several factors that restrict a country from experiencing the full benefits of FDI. For example, Sosukpaibul (2007) emphasised that, in some developing countries, the level of general education and health, level of technology in host-country enterprises, prevailing policy on openness to trade, competition, and inadequate regulatory frameworks have created significant barriers to fully embracing the benefits of FDI. Conversely, technological, educational and infrastructure achievement in developing countries create a better chance of benefiting from foreign presence in the domestic market. Importantly, the effect of government investment policy on FDI differs in different sectors. In Thailand, Sosukpaibul (2007) found that the effect of
government investment policy on FDI in the agriculture and services sector was positive, but not significant. Bilateral agreements also appeared to be an important factor in attracting FDI for electrical appliances, textile, agriculture, automobiles and services. Therefore, selective government policies can generate higher FDI and stimulate flows of investment. The conclusion drawn from Sosukpaibul is that investment promotion policies implemented by governments should be used further.

Under an investment promotion policy, labour quality is a key factor for attracting FDI; thus, devoting more of the government budget to developing education may increase the quantity of higher skilled labour, which is a catalyst for the inflow of appropriate FDI relative to the host’s environment (Sosukpaibul, 2007).

Consequently, this study aimed to examine how FDI affects different sectors of the economy. To achieve this, it investigates the government’s recent FDI promotion campaign in different areas. Specifically, it explores the macroeconomic effect of the Thai government’s investment policies on FDI, classified by economic sectors, such as tourism, manufacturing, agriculture, education, health and services. The novelty of the thesis is that the research plans to endogenously determines policy choices within the political economy framework that recognises the trade-offs between attracting FDI and maintaining a competitive domestic economy. The expected outcome should assist the Thai policy makers in attracting FDI to different sectors of the economy that has the highest growth potential for a sustainable development regime.

1.5 Statement of Problem

During the past decade, Thailand has heavily relied on the inflow of FDI to stimulate economic activities, particularly in the manufacturing, tourism and services industries. However, without any support from empirical evidence, the effect of FDI on Thailand’s economic growth remains largely questionable. Therefore, this study sought
to determine the effects of FDI on Thailand’s economic growth and development, as well as its policy implications, by answering the following questions:

1. What are the determinants of FDI in Thailand?
2. Can any significant unidirectional or bidirectional relationship be found between Thailand’s inward FDI and economic growth?
3. Has the country’s previous focus on FDI been rightly placed as a main driver of Thailand’s economic growth?
4. How effective has the Thai government’s FDI policy been in stimulating investment and growth in the key sectors of the economy?
5. On which areas should the government and policymakers focus to enable more sustainable economic development for Thailand’s future?

1.6 Research Methods

The study’s first empirical analysis aimed to identify the major determinants of FDI inflows to Thailand over the period 1990 to 2013, based on a model taken from Daly and Tosompark (2011). The following specification was built according to the discussion in the former literature:

$$ FDI_{it} = f (RWA_{it}, RIR_{it}, ER_{it}, NX_{it}, RGDP_{it}) $$

where:

- $ FDI $ = the annual flow of real FDI inflow Thailand
- $ RWA $ = real wage average
- $ RIR $ = interest rate spread (deposit-lending rate) as a ratio of US spread
- $ ER $ = the real exchange rate (local currency unit)
- $ NX $ = Thailand net exports
- $ RGDP $ = real GDP/capita
The log-linear form of Equation (1) is:

$$\ln \text{FDI}_{it} = \alpha + \beta_1 \text{RWA}_{it} + \beta_2 \ln \text{RIR} + \beta_3 \text{ER}_{it} + \beta_4 \text{Dummy} + \beta_5 \ln \text{NX}_{it} + \beta_6 \ln \text{RGDP}_{it} + \varepsilon_t$$

(2)

The second model attempted to quantify the contribution of FDI to Thailand. This study applied a simple regression to analyse the importance of FDI in promoting the growth of nine subsectors of the economy: construction, manufacturing, finances, wholesale and retail trade, agriculture, transport, electricity, real estate, and hotels and restaurants. In addition to using FDI as the main variable of interest, this study included other selected variables (employment, capital formation, exports and a dummy variable—crisis) for the period of observation (2005 to 2014). In stylised form, the model was:

$$\text{Sectoral Output}_{it} = \text{Constant} + \text{FDI}_{it} + \text{Employment}_{it} + \text{Crisis} + \text{Exports}_{it} + \text{Capital Formation}_{it} + \varepsilon_{it}$$

1.7 Thesis Contribution to Literature

FDI is an integral part of an open and effective international economic system, and a major catalyst for economic development. However, the benefits of FDI do not accrue automatically and evenly across countries, sectors and local communities. National policies and the structure of international investment are important for attracting FDI to a larger number of developing countries, and for reaping the full benefits of FDI for development. In the case of Thailand, where domestic legal, competition and environmental frameworks are undeniably weak and weakly enforced, the presence of financially strong foreign enterprises may not be sufficient to assist economic development. Thus, the challenge is how to establish a transparent, broad and effective enabling policy environment for investment, and to build the human and institutional capacities to implement this.
Accordingly, this thesis aimed to determine how best to pursue domestic policies to maximise the benefits of foreign firms in a domestic economy. It studied FDI primarily to attempt to shed light on these fundamental issues by focusing on the overall effect of FDI on macroeconomic growth and other welfare-enhancing processes, and on the channels through which these benefits take effect. However, the influences of specific government policies on investment decisions and their effects are not well understood, particularly the structural changes to the Thai economy since the 1997 Asian financial crisis (AFC) onwards. This study adds to the existing literature by empirically testing the response of FDI inflows to the current Thai government’s FDI promotions and investment agreements, and thus determines the significance of the government’s policies in attracting FDI flows to Thailand.
Chapter 2: Theoretical Framework

2.1 Introduction

This chapter provides a comprehensive synthesis and evaluation of previous studies on multinational enterprises (MNEs) and FDI. It focuses on the post-war development of the international trade environment, and chronologically describes the main ideas from earlier work based on the neoclassical growth model from the 1960s, to subsequent theories based on market imperfections, such as the product life cycle (PLC) theory, internationalisation theory and Dunning’s eclectic paradigm (ownership, location and internalisation [OLI] theory). This chapter also examines more recent theorems under the new trade and institutional approach.

This discussion includes collective arguments and findings on FDI determinants extracted from several studies. As an empirical contribution to the literature, this chapter assumes the relevance of each theory based on country-specific factors and conducts a simple regression analysis to determine the factors that influence FDI inflow to Thailand. In terms of qualitative discussion, this chapter determines the institutional approach to be most relevant and appropriate, and employs this as the preferred view of Thailand’s FDI. Finally, this chapter examines the effects of MNEs and FDI on host economies from various literature, examined in the context of growth and development controversy. It considers past literature to find evidence of spillover effects, and emphasises FDI’s effects on output growth, employment and wages, balance of payments (BOP), trade flows, international competitiveness, productivity, technology diffusion, human capital, market structures, income inequality, national welfare and poverty reduction, and country interdependency.
2.2 FDI Theories

2.2.1 Neoclassical growth model. As recognised by previous literature reviews of FDI, Solow’s 1956 neoclassical growth model was one of the first theories that introduced the idea of international trade, technological progress and long-term growth. According to Miankhel et al. (2009), the FDI–growth nexus was first implied in the discussion of technological progress and labour force, which were both taken as exogenous, in order to argue that FDI advances growth only if it positively influences technology. In general, the theory suggested that, if international investment does not enhance technology, it only generates an increase in the level of income, and has no effect on the host country’s long-term growth. In particular, if FDI takes the form of mergers and acquisitions, it does not contribute to complementary capital formation or growth, but merely transfers assets from the domestic owner to foreign owner. Moreover, there are issues of ‘crowding out’, whereby foreign investors borrow from local financial markets and subsequently cause interest rates to increase and local firms’ projects to be adjusted to the availability of skilled labour, scarce resources and profit repatriation (OECD, 2002).

2.2.2 PLC theory. As studies of FDI were pursued more thoroughly, researchers argued that the neoclassical trade theory could not fully explain FDI flows. A more defined FDI theory emerged in Vernon’s (1966) PLC theory, in which he explained the rationale for outward FDI from the US. Vernon observed that the US market had become a major importer of many of the goods that it had once developed, produced and exported over time. Vernon explained the pattern of international trade and investment based on the technological gap between advanced economies and developing countries, and reasoned that, when production technology stabilises, demand for a product increases and the product may be increasingly manufactured outside the
source country. This theory also implies that, over time, the main exporter may change from exporter to importer, thereby allowing low-cost producers to become exporters.

However, rivalry between firms affects their decisions to reduce production costs to become more competitive. This led Vernon (1966) to explore the theory of PLC. He found that firms choose to invest directly in a foreign country as an alternative to exporting, insofar as goods travel along the curve of their lifecycle of growth, maturity and decline. During the growth stage, companies invest in other developed countries where markets are growing and local production can be absorbed. In the maturity and decline stages, production is shifted to developing countries when there are fewer needs in terms of specialised labour and innovative technology. Markets become saturated and products become less innovative, thereby generating pressure to reduce costs (Hill, 2007). Aharoni (1966) explained that companies may also consider FDI due to competition factors, such as the fear of increased competition in the domestic market, fear of losing their own competitiveness, and the need to follow rivals into foreign markets.

The PLC theory postulates that most products follow a similar lifecycle. In the first stage, the product appears as an innovation that is sold locally in the same country that it is produced, such as the US. This satisfies the local demand while creating an efficient coordination between research, development and production units. In the second stage, the product begins to be exported to another country, such as Western Europe. In the third stage, some competitors arise in Europe. If conditions are favourable, the firm will establish foreign subsidiaries in Europe to face the increased competition, and may establish subsidiaries in less developed countries to access cheaper labour costs in order to enhance competitiveness.
Although the PLC theory is successful in explaining the relationship between exports of US industries in relation to the degree of product innovation and non-standardisation, and is widely used as a generalised framework in many studies, there are some limitations to the theory. First, the PLC model cannot account for the increasing proportion of foreign investment that is not export-substituting. Second, this theory may be constrained by Vernon’s ethnocentric view because the original study was completed in the 1960s. The world’s trading importing and exporting have changed immensely over the years of globalisation, during which technology and income gaps between the US market and foreign locations have lessened significantly. Thus, changes in the international environment have weakened the critical assumption of the PLC theory (Sosukpaibul, 2007).

Vernon (1979) himself has recognised that circumstances have changed rapidly since his theory was developed, and that this has considerably weakened its predictive power. Nevertheless, the PLC theory provides a framework under which a number of authors have dealt with crucial questions about FDI. Additionally, the PLC concept is similar to the Japanese ‘flying geese’ economic model, originally proposed by Akamatsu (1962) and later developed by Kojima (1975, 2000) and Kojima and Ozawa (1977). Upon comparison, Vernon’s model is generally criticised for not sufficiently incorporating the organisational structure of the firm in the analysis. While the PLC appears to be a purely economic concept, the flying geese theory takes a more political view, in which Japan is placed as the centre of the region (Dunning, 1990).

2.2.3 Hymer-Kindleberger theory. Another earlier contribution to FDI theory is the Hymer-Kindleberger (HK) theory, which separates FDI from other foreign capital movement. Hymer (1960) and Kindleberger (1969) suggested that there must be market imperfections in order for goods or factors of production to encourage FDI. Both Hymer
and Kindleberger focused on the concept of the ‘imperfect market’ and ‘monopolistic advantage’ as a way to explain why firms enter foreign markets. Hymer (1976) confirmed that MNEs entail some disadvantages because investment abroad involves high costs and risks because they are foreign (Sahoo et al., 2013). These drawbacks present as the cost of acquiring information due to cultural and language differences, and possibly the cost of less favourable treatment by the governments of host countries. Thus, it is natural to assume that there must be a form of economic distortion that determines the realisation of FDI. According to Denisia (2010), Two necessary conditions are:

1. foreign firms must possess certain advantages that enable such an investment to be viable
2. the market of these benefits must be imperfect.

Similarly, Knickerbocker (1973) hypothesised that FDI is a result of oligopolistic reaction. He based his study on the relationship between FDI and the oligopoly rivalry between firms, and stated that FDI flows reflect the strategic rivalry between companies in the global market that results from reactive behaviour to the entry of competitors to certain markets. That is, firms often have imitative behaviour—they follow the internationalisation of competitors to prevent them from gaining strategic advantage (Knickerbocker, 1973). In the US, Flowers (1975) empirically tested Knickerbocker’s hypothesis on FDI from Canada and Europe, and found a significant positive correlation between the concentration of FDI in the US and the concentration in the investing countries (Agarwal, 1980). Thus far, the arguments made by Caves (1971), Knickerbocker (1973), Rugman (1979), Pitelis (2000) and Buckley and Casson (1976, 2009) all supported the HK theory and suggested that there are deficiencies in the
market. They argued that it is the differential in firm-specific advantage that encourages firms to internalise and conduct FDI.

## 2.2.4 Internalisation theory

Similarly, subsequent theories such as the internalisation theory emerged to explain the growth of MNEs and their motivations for achieving FDI. The internalisation theory was developed by Buckley and Casson (1976), Hennart (1982) and Casson (1983). The original form of the theory was initially launched by Coase in 1937 in a national context, and expanded by Hymer in 1976 in an international context. Buckley and Casson (1976) built on the existing theory and demonstrated that MNEs tend to organise their internal activities in a manner that will develop specific advantages. The theory was later extended by Hennart (1982) to consider two types of integration in the internalisation context: vertical and horizontal. Internalisation theory is considered very important by Dunning, who recognised its significance, yet argued that it explains only part of FDI flows (Buckley, 2009; Rugman et al., 2011).

## 2.2.5 Dunning’s eclectic paradigm (OLI theory)

After observing that MNEs incur higher costs when undertaking business abroad than do domestic firms, Dunning (1973) reasoned that foreign firms must have offsetting advantages over local firms in order to become successful. Dunning’s theory was originally proposed in 1977 and reiterated throughout the years in 1979, 1980, 1981, 1988, 1995, 2000 and 2001. It expands on the internalisation theory by suggesting that three conditions are required for FDI to occur. Firms must have these three conditions, which constitute the basis of the eclectic paradigm—or OLI theory, where OLI stands for ‘ownership, location and internalisation’.

First, a firm must have ‘ownership advantage’. For example, it must have market power as an oligopolistic firm, or must own assets such as natural limited resources,
pioneering technology, exclusive productive processes, patents, trademarks, management skills and so forth. This will allow them to compete with local firms, despite the disadvantages of being foreign. Thus, the firm must have a product or production process that is superior to other firms, and thus gives them an advantage in foreign markets (Dunning & Archer, 1987).

Second, firms must have a ‘location advantage’, whereby they must have a reason to want to locate production abroad instead of expanding in their home country or engaging in simple market-based transactions, such as trade and licensing. Benefiting conditions that induce FDI may come in the form of special tax regimes; lower production and transport costs; market size; access to protected markets, resources or telecommunication; or lower risk (Dunning & Lundan, 2008). Additionally, political benefits can be found in specific government policies related to FDI, while social benefits can be found in cultural diversity, attitudes towards foreigners, and distances between home and host countries (Denisia, 2010).

Finally, firms must have an ‘internalisation advantage’, whereby they must have a reason to want to exploit their ownership advantage internally, rather than licensing or selling their product or process to a foreign firm. Consistent with the HK and internationalisation theories, the OLI theory confirms the existence of market imperfections (such as the imbalance of international allocation of resources) that can be reduced by internalising operations, which can, for example, allow a reduction in the transaction costs associated with the risks of copying technology (Dunning & Narula, 2003).

The major contribution of Dunning’s eclectic paradigm to the literature was to bring together several complementary theories by identifying a set of variables (ownership, location and internalisation) that shape the activities of MNEs (Dunning &
PLOTICAL ECONOMY OF FDI IN THAILAND

Lundan, 2008). The model suggests that the type of advantages a firm possesses (ownership, location or internalisation) will determine the mode of entry in which it engages (FDI, exports or licensing) (see Table 2.1). It is a useful tool for assessing FDI generally by describing the conditions that lead a firm to invest abroad. The variables discussed in the paradigm are reflected in managerial perceptions of asset power, market attractiveness and the costs of integration. Pitelis (2000) concisely stated that the OLI theory is essentially comprised of three main concepts that earlier scholars adopted to explain the existence of MNEs and FDI—namely, the monopolistic advantage by Hymer (1976), the concept of internalisation by Buckley and Casson (1976) and the theory of locations by Vernon (1966) and Buckley and Casson (1976).

Table 2.1

*Relationship between OLI Advantages and Entry Mode Based on Dunning’s Eclectic Paradigm*

<table>
<thead>
<tr>
<th>Mode of entry</th>
<th>Advantages</th>
<th>Ownership</th>
<th>Location</th>
<th>Internalisation</th>
</tr>
</thead>
<tbody>
<tr>
<td>FDI</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td></td>
</tr>
<tr>
<td>Exports</td>
<td>Yes</td>
<td>Yes</td>
<td>No</td>
<td></td>
</tr>
<tr>
<td>Licensing</td>
<td>Yes</td>
<td>No</td>
<td>No</td>
<td></td>
</tr>
</tbody>
</table>


Thus far, many empirical studies (Conyon et al., 2002; Djankov & Hoekman, 2000; Doms & Jensen, 1998; Evenett & Voicu, 2001; Helpman et al., 2004; Lipsey, 2002) have implemented either total factor productivity (TFP) or labour productivity analysis, and found that MNEs have a very distinctive bundle of capabilities and do possess ownership advantages according to Dunning’s OLI theory.

2.2.6 Institutional approach. Through reviewing the international business literature, this study detected interesting, if limited, observations regarding the effect of
political instability and political risk on FDI. This intellectual proposition led to an institutional approach to FDI theory. Within the institutional approach, researchers examine the possibility that a firm’s investment decisions largely depend on political factors embodied in institutions. The idea is to assess MNEs’ and FDI’s effects on countries’ economic openness, development path, policies for entrepreneurship, and type of governance that affects business freedom. Considered by various researchers (e.g. Benassy-Quere et al., 2001; Loree & Guisinger, 1995; Root & Ahmed, 1978), the institutional approach typically assimilates political variables, such as financial and economic incentives, tariffs, tax rates, political risk and institutional quality. According to Kinoshita and Campos (2006) and Popovici and Calin (2013), once these factors are taken into consideration, other usual determinants—such as market size and labour cost—become less significant. Theories that emphasise the role of institutions in attracting FDI are known as ‘institutional theory’.

Institutional theory suggests that firms operating in an unfamiliar environment depend on the institutional forces that govern the ‘rules of the game’. That is, firms’ performance in international markets is determined by government policies, such as tax breaks, subsidies and uncomplicated repatriation of capital and profit, which influences firms’ decisions regarding FDI, exporting and licensing. This issue has been examined by a number of authors. Earlier work by Bond and Samuelson (1986), Black and Hoyt (1989) and Hubert and Pain (2002) concluded that financial and fiscal incentives, tariffs and lower corporate tax rates have a positive effect on attracting FDI (Faeth, 2009). In contrast, Bénassy-Quéré et al. (2007) found an increasing significance of institutions for FDI in the 1990s as a result of the transition process in Central and Eastern European countries. Assunção et al. (2011) suggested that FDI is a result of the competition between governments, where the ‘game rules’ are created by institutions.
Others researchers, such as Bénassy-Quéré et al. (2007) and Cleeve (2008), indicated corruption as another important factor in firms’ FDI decisions, asserting that low levels of corruption are linked to greater prosperity and have a significant effect on the institutional quality and future development of the country. Many studies have been undertaken to determine the actual relationship between institutional quality and FDI. Following Lensink and Morrissey (2006), who found institutional quality to be negatively and significantly associated with FDI volatility, Buchanan et al. (2012) examined the effect of institutional quality on FDI levels and volatility, based on a panel data analysis of 164 countries from 1996 to 2006. Buchanan found that good institutional quality had a positive and significant effect on FDI. The study emphasised the importance of institutional reform consistent with policy prescription for attracting FDI into countries.

2.2.7 Summary of FDI theories. Overall, the various theories on FDI establish a number of determinants that could explain FDI flows, involving micro dimensions (such as organisational aspects) and macro dimensions (such as resource allocation) (Dunning & Lundan, 2008). However, due to the popularity and continuity of the subject, no single study has been able to encompass all existing theories of FDI. However, many studies have attempted to identify the main trends in FDI theory and highlight how these theories were developed to account for changing international environment over time. Below is an example from a recent study of theories of FDI determinants by Assunção et al. (2011).
### Table 2.2

**Summary of Theories of FDI Determinants**

<table>
<thead>
<tr>
<th>Theory/Theoretical approach</th>
<th>Determinants</th>
<th>Author(s) (Year)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Heckscher-Ohlin Model / MacDougall-Kemp Model</td>
<td>Higher return on investment, lower labour costs, exchange risk</td>
<td>Heckscher and Ohlin (1933), Hobson (1914), Jasay (1960), MacDougall (1960), Kemp (1964), Aliber (1970)</td>
</tr>
<tr>
<td>Market imperfections</td>
<td>Ownership benefits (product differentiation), economies of scale, government incentives</td>
<td>Hymer (1976), Kindleberger (1969)</td>
</tr>
<tr>
<td>Product differentiation</td>
<td>Imperfect competition</td>
<td>Caves (1971)</td>
</tr>
<tr>
<td>Oligopoly markets</td>
<td>Following rivals, responding to competition in domestic market</td>
<td>Knellerbocker (1973)</td>
</tr>
<tr>
<td>Product life cycle</td>
<td>Production function characteristics</td>
<td>Vernon (1966)</td>
</tr>
<tr>
<td>Behaviour theory</td>
<td>Fear of loss of competitive edge, following rivals and increased competition at home</td>
<td>Aharoni (1966)</td>
</tr>
<tr>
<td>Internalisation</td>
<td>Market failures/inefficiencies</td>
<td>Buckley and Casson (1976)</td>
</tr>
<tr>
<td>Eclectic paradigm (OLI—Ownership, location, internalisation)</td>
<td>Benefit of owning productive processes, patents, technology, management skills</td>
<td>Dunning (1977, 1979)</td>
</tr>
<tr>
<td></td>
<td>Advantage of locating in protected markets, favourable tax systems, low production and transport costs, lower risk</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Advantage of internalisation cutting transaction costs, lowering risk of copying technology, quality control</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Transport costs</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Barriers to entry</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Factor endowments</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Tariffs</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Tax rate</td>
<td></td>
</tr>
</tbody>
</table>

Source: Assunção et al. (2011).

### 2.3 Chapter Summary

To understand FDI, one must first understand the basic motivations that cause a firm to invest abroad, rather than exporting or outsourcing production to national firms.
The above review covered the main trends in FDI theory and highlighted how these theories were developed. Ultimately, most studies were commonly motivated by the need to find new approaches to enrich economic theory of FDI. However, it is clear that, while numerous researchers have sought to explain the phenomenon of FDI, there is no generally accepted theory, and every new outcome reveals new aspects or criticisms of previous ones.
Chapter 3: Empirical Modelling of FDI

3.1 FDI Determinants

There is not one single theory of FDI, but a variety of theoretical models attempting to explain FDI and the location decision of multinational firms. Therefore, any analysis of determinants of FDI should not be based on a single theoretical model. (Faeth, 2009)

Vast quantities of empirical literature on FDI have identified a long list of determinants that allegedly explain FDI in particular locations. While it is undeniable that no study can attain a completely coherent result across different industries and countries, this study’s literature review attempted to single out the most robust factors explaining the geographic distribution of FDI flows in previous studies. Evidence from in-depth studies (e.g. Agarwal, 1980; Assunção et al., 2011; Bitzenis, 2003; Chakrabarti, 2001; Gastanaga et al., 1998; Moosa, 2002) indicated that the most established variables are local market size, local labour cost and capital endowment, taxes levied, exchange rates, local economic growth, political and economic risk, and local infrastructure.

3.1.1 Market size. ‘The main consensus is that marketing factors, in particular market size, market demand, market growth and maintaining market share were the main determinants of FDI’ (Faeth, 2009). Theoretically, a large or growing host market is perceived to be a positive sign for profitable investments. Love and Lage-Hidalgo (2000), Lipsey (2000) and Moosa (2002) highlighted how domestic market size and differences in factor costs can relate to the location of FDI. This is because foreign investors can only exploit the economies of scale after attaining a certain threshold size of the market. In empirical studies, market size effect is generally measured by GDP, GDP per capita, gross national product (GNP), GNP per capita, or the growth rate of
these factors (Daly & Tosompark, 2011). This was reflected in earlier studies by Kolde
(1968), Wilkins (1970) and Andrews (1972). It was confirmed by the more recent work
of Dees (1998) and Zhang (2000), who found a significant and positive influence of
market size on inward FDI.

3.1.2 Labour cost. ‘High nominal wage, other things being equal, deters FDI’
(Aqeel & Nishat, 2004). While the results of the effects of labour cost on FDI inflows
are ambiguous in some cases, it is generally agreed that lower labour costs and higher
unemployment attract FDI funds (Barrell & Pain 1997; Mody & Srinivasan, 1998).
Since labour cost is an important aspect of total production costs, this must be
particularly true for firms engaging in labour-intensive production activities. Therefore,
conventionally, the expected sign between the labour costs and inward FDI is negative.
Studies that have found no significant relationship or a negative relationship for this
determinant include Schneider and Frey (1985), Wheeler and Mody (1990), Lucas
However, the effect of labour costs on FDI flow remains unclear because
that there might be a positive relationship or no significant influence. Daly and
Tosompark (2011) concluded that the lower the labour cost in the host country, the
more attractive it is for foreign investment. Lower labour costs have obvious attraction
for MNEs. However, the literature has also indicated that a positive relationship may
occur because the wage rate could be considered a signal of labour quality. Adjusted for
inflation, a higher wage rate may indicate higher skilled labour and higher productivity,
which foreign investors seek if they prefer high-quality labour to cheap labour with low
productivity. This was found by Moore (1993) and Love and Lage-Hidalgo (2000).

3.1.3 Cost of capital.
The impact of cost of capital (i.e. lending interest rates) on FDI inflows is found to be ambiguous in nature and statistically insignificant by many studies. On one hand, it can be argued that higher lending rates may have a positive impact on FDI inflows, i.e., higher the cost of capital in the host country the more capital is brought in by the foreign firms. Alternatively, it can be argued that host country’s cost of capital impacts directly on domestic consumption. Thus the lower the interest rates, the higher the domestic consumption and hence higher the FDI inflows. (Chopra & Sachdeva, 2014, p. 328)

FDI is essentially financed by the home country. If the cost of borrowing in the home country is lower than that in the host country, home country firms can have a cost advantage over host country rivals, and are in a better position in terms of the cost of capital to enter the host country market via FDI. Thus, the higher the ratio of host country borrowing costs to home country costs, the higher the inward FDI in the host country. However, this relationship is not commonly supported because, in reality, MNEs can finance their activities from the international capital market as well as the local market (Gelan, 2004).

Discussions about the influence of interest rates on FDI are ambiguous because higher interest rates may indicate a booming local economy, which may have a positive effect on FDI (Liu et al., 1997). A recent empirical study by Daly and Tosompark (2011) estimated the cost of capital in terms of interest rate spread for Thailand, and found that the sign appeared negative, yet insignificant, which indicated that the local interest rate—as measured by the spread in deposit to lending rates—had a negative influence on FDI inflow.

3.1.4 Exchange rate. ‘A depreciation of the host currency should increase FDI into the host country, and conversely an appreciation of the host currency should
decrease FDI’ (Froot & Stein, 1991). The effect of exchange rate movements on FDI flows is a fairly well studied topic because changes in exchange rates have direct effects on production costs in host countries, compared to home countries. Thus, the exchange rate is an important consideration for MNEs in determining FDI, and past empirical studies reflected the strong influence of exchange rate movement on FDI.

Different approaches to examine the influence of exchange rates on FDI can be found in the early works of Aliber (1970, 1971), Caves (1988) and Froot and Stein (1991). A common hypothesis is that FDI flows into countries with low real currency values, and flows out of countries with high real currency values. However, there has never been a conclusive result because the direction and magnitude of influence is often ambiguous. According to Brewer (1993), governments often contribute to deviations in currency values from parity levels through a combination of foreign exchange controls, interest rate policies, exchange market interventions and/or other policies.

Another theory in this context was propounded by Caves (1988) in one of his later writings. On finding a negative correlation between the level of exchange rate and level of FDI in the US, Caves explored how exchange rate affects FDI. He highlighted the cost and revenue effect in which, if the domestic currency depreciates, the import payments will build up and diminish net income—unless export expands in the face of depreciation, in which case, income will rise. Similarly, a study by Daly and Tosomparak (2011) suggested that, if FDI promotes production for re-exports, it is complementary to international trade; thus, an appreciation of the local currency would decrease exports through higher price and supposedly reduce FDI inflows. However, if FDI aims to serve the local market, FDI and trade are a substitute for each other. In this case, an appreciation of the local currency increases FDI inflows due to the higher purchasing power of local consumers. Empirically, the results of many studies fail to reach
consensus. Further research on how to measure expected exchange rate levels, uncertainty or volatility may contribute to the FDI literature. Although it is not the sole focus of this thesis, the topic of exchange rates’ effects on FDI is an area rich for future work, particularly for developing countries with a different exchange rate regime.

3.1.5 Government policy. ‘FDI from developed and developing countries may seek to fulfil different objectives and therefore may be attracted to different set of policies of the host governments’ (Banga, 2003). Brewer (1993) discussed various types of government policies that can directly and indirectly affect FDI through their effects on market imperfections. There is a possibility that the same government policy can increase and/or decrease market imperfections, and thus increase and/or decrease FDI inflows. Unsurprisingly, the empirical evidence regarding the effect of selective government policies on FDI inflows appears ambiguous.

Grubert and Mutti (1991), Loree and Guisinger (1995), Taylor (2000) and Kumar and Pradhan (2002) found a positive effect of investment incentives and a negative effect of performance requirements imposed by host governments on inward FDI flows. Meanwhile, Devereux and Griffith (1998) and Hines (1996) found that fiscal incentives significantly affect location decisions for export-oriented FDI. In contrast, Contractor (1991) found that policy changes have a weak influence on FDI inflows, while Caves (1996) and Villela and Barreix (2002) concluded that incentives are generally ineffective once the role of the fundamental determinants of FDI is considered. In their study, Hoekman and Saggi (2000) concluded that incentives may attract certain types of FDI, but cannot be presumed at an economy-wide level. Blomstrom and Kokko (2002) discussed whether FDI incentives are justified for host economies, given that this entails a transfer of resources from host countries to foreign firms.
Some studies have tested the effect of openness to trade and regional agreements in trade on FDI inflows, and found them to be important determinants (Asiedu, 2002; Chakrabarti, 2001; Gastanaga et al., 1998; Taylor, 2000). Globerman and Shapiro (1999) found that the Canada–US Free Trade Agreement and North American Free Trade Agreement have had positive effects on both inward and outward FDI. Blomstrom and Kokko (1997) found different effects with different types of tariff, in which lowering interregional tariffs could lead to increased FDI, while lowering external tariffs could lower FDI in the region if the FDI was tariff jumping.\(^2\)

However, there are problems with empirically testing the determinants of FDI location, associated with the operationalisation\(^3\) of the policy variables—mostly due to the unpredictability of their occurrences. For example, Contractor (1991) examined government announcements of policies, rather than investor-reported incidences of restrictive policies; however, this limited the generalisability of his findings. Brewer (1993) analysed the effect of government policies on market imperfections and FDI through relevant government policies, the converse effects on market imperfections and FDI, and their differential effects on separate components of FDI flows.

Types of FDI policies implemented differ substantially between developed and developing countries. Thus, the interaction terms between development status and policy measures need to be examined in order to determine how the effect of policies on FDI flows differ between developed and developing countries. For example, Loree (1995) examined the effects of policy and non-policy variables on the location of new US direct investment abroad, using benchmark data from 1977 and 1982. Loree found significant positive effects for investment incentives, significant negative effects for

\(^2\) ‘Tariff jumping’ essentially refers to establishing a production facility in a foreign country, through FDI or licensing, in order to avoid a tariff. See Xu (2001), Hwang (2002) and Blonigen et al. (2004) for a detailed discussion of tariff jumping.

\(^3\) ‘Operationalisation’ is the specification of empirical indicators of an underlying phenomenon that is not directly measurable, but its existence is evidenced by other indicators.
performance requirements, and significant negative effects for host country effective tax rates, with interesting differences between the two time periods and between developed and developing countries. Loree also found a significant influence of non-policy variables, such as political stability, cultural distance, GDP per capita and infrastructure.

3.1.6 Infrastructure. ‘The well-established and quality infrastructure is an important determinant of FDI flows.’ (Vijayakumar et al., 2010, p.5). As improved infrastructure in the host country influences expenditure by MNEs, it may be expected that there is a strong relationship between infrastructure and FDI. However, empirical studies show mixed evidence. While Biswas (2002), Asiedu (2006), Mhlanga et al. (2010) and Vijayakumar et al. (2010) found a significant positive relationship between two variables, Botrić and Škuflić (2006) found negative results, and Cleeve (2008) and Mohamed and Sidiropoulos (2010) found no statistical evidence that infrastructure attracts FDI.

3.1.7 Institutional quality. ‘In the aftermath of the 1997 AFC, many countries started to reform their institutional policies, legislation and institutional arrangements in order to attract more FDI’ (Buchanan et al., 2011). Discussion of the effects of institutional quality on FDI has gained much attention since the late 1990s. Much literature on economic development has identified institutional quality as the key factor explaining the differences in development between countries, with low levels of corruption associated with greater prosperity (Bénassy-Quéré et al., 2007). In regard to FDI, variables such as corruption, political instability and weak institutional quality are considered institutional. These instabilities have an expected negative effect on FDI determinants because they can lead to political risk losses that threaten corporate financial positions and increase the costs of doing businesses. In contrast, countries that
endorse transparency in their political dealings and continuously improve their institutional qualities will attract more FDI and investment in general.

### 3.1.8 Governance

The prevailing view is that countries with good governance tend to attract more FDI because in the absence of good governance, investment cannot be protected (Globerman & Shapiro, 2003). The importance of institutions lies in the ‘rules of the game’ that guide society and, if effective, reduce uncertainty and transaction costs in human interactions. The real performance of economic institutions differs widely among countries and is largely determined by governance. Apropos of FDI, good governance encourages investment, while bad governance impedes businesses and increases transaction costs. Therefore, governance is often assumed to be an important determinant of FDI.

Good governance exists when the national authority is exercised under independent judiciary and legislation, fair and transparent laws, and accessible financial information. Poor governance may expose MNEs to higher costs and uncertainty through extensive regulation; discretion, rather than rule; red tape; lack of skilled personnel; administrative inefficiency; an unfair tax system; complicated rules to establish a firm; lack of transparency; and weak protection of property rights. Therefore, good governance is commonly argued to be an important determinant of FDI. However, this view is not unanimous, and was disputed by Wheeler and Moody (1992), Hines (1995), Habib and Zurawicki (2002), Li and Filer (2004), Li (2005), Henisz (2000), Moskalev (2007) and Pinto and Zhu (2009). In contrast to the arguments above, Li (2005) argued that the absence of good governance does not imply the absence of protection because a ‘relation-based governance’ system replaces the ‘rule-based governance’ system in order to govern social and economic transactions. That is, in the
absence of good governance, firms predominately rely on private relationships to protect their business.

Pinto and Zhu (2009) made an interesting observation, stating that ‘in more democratic and developed countries, increasing FDI inflows are likely to contribute to reduction of corruption, while in non-democratic and less developed countries, a rise in FDI inflows is associated with a higher level of corruption’. Pinto and Zhu suggested that, in a poor governance environment, foreign firms have few incentives to try to improve governance. Firms that benefit from poor governance through paying bribes clearly have no incentive to speak against it, while firms that lose business contracts because of corruption may prefer to remain silent for two reasons. First, speaking out or prosecuting often fail because of the weak legal system and strong relationship between the involved individual and the courts. Second, business is a repeated game, and losers of a single business contract may not wish to damage their relationship with local authorities because of the opportunity to gain a different contract in the future. Complaining about poor governance is likely to create hostility and reduce opportunities to gain future contracts (Pinto & Zhu, 2009).

Finally, no consensus has been reached because, on one side, an Organisation for Economic Co-operation and Development (OECD) (2002) report suggested that, as long as good governance conditions prevail, no special incentives are needed to attract FDI. However, on the other side, many argue that poor governance may be a source of rent—not only for corrupt politicians and policymakers in the target countries, but also for large multinational corporations. Thus, one cannot rule out the possibility that poor governance can make investment opportunities appear more attractive in particular circumstances.
3.1.9 Corruption. ‘Corruption deters FDI because it distorts the economic and financial environment, and reduces government and business efficiency’ (Shleifer & Vishny 1993). In the case of corruption, the literature is richer than with other governance indicators. According to Bellos (2012a), two views have emerged from the broad literature examining the effects of corruption on FDI: ‘sand the wheels’ and ‘grease the wheels’. The dominant ‘sand the wheels’ view suggests that corruption is a sign that the government is malfunctioning, which deters FDI. Corruption can discourage foreign investors because it can increase direct costs in the form of bribery, which is linked with policies, such as import and export licenses, exchange controls, tax assessments and subsidies. Further, it may cause the government to create unnecessary bottlenecks, weaken the transparency and predictability of property rights systems, create an uneven playing field against foreign firms, increase the risks of breached contracts, reduce the quality of government services and infrastructure, and create barriers to obtaining import permits and connections to public utilities. In short, corruption can deter FDI by distorting the economic and financial environment, and reducing the efficiency of the government (Bellos, 2012a). Empirical evidence that high corruption levels deter FDI in transition countries is provided by Resmini (2000), Hellman et al. (2002), Bevan and Estrin (2004), Caetano and Caleiro (2005) and Cuervo-Cazurra (2006).

In contrast, the opposite ‘grease the wheels’ view argues that corruption can sometimes compensate for poor governance, and attract more FDI (Aidt, 2003; Bardhan, 1999; Egger & Winner, 2005; Kaufmann & Wei, 1999; Leys, 1965; Lien, 1986; Lui, 1985; Méon & Sekkat, 2005; Olson, 1993; Shleifer & Vishny, 1993). This view suggests that, when corruption and low government quality coincide, various forms of bribery can speed up processes in a sluggish administration, overcome
restrictive bureaucratic regulations, improve the quality of civil servants when wages are low, and increase competitive sale under the assumption that licenses tend to be allocated to more generous bribers, who can be more efficient. Therefore, special privileges gained through corruption and bribery can compensate for poor governance, and attract more FDI. This view is supported by empirical evidence from Wheeler and Moody (1992), Hines (1995), Habib and Zurawicki (2002), Henisz (2000) and Moskalev (2007).

3.1.10 Political instabilities. ‘The stability of the host country can be one of the most important considerations in the FDI decision’ (Schollhammer, 1974). Kobrin’s (1978) work underscored this statement by finding a negative relationship between political instability and FDI. Haller and Richter (1994) viewed political instability as of foremost importance in determining FDI, especially for tourism investment, in which the industry promotes serenity, leisure, fun and comfort, which can only be marketed under stable conditions. Thus, the relationship between these two factors is expected to be negative. Later studies by Schneider and Frey (1985), Brunetti (1997) and Jun and Singh (1996) confirmed this by concluding that political instability and violence make a country less attractive for FDI because they render the economic and political context less predictable. Therefore, with respect to political instability, most studies have evidenced the negative result expected for this determinant in relation to FDI.

Further investigations have revealed a broader range of studies examining political risk and FDI. Political risk is the risk associated with business exposure to losses due to government actions or institutional constraints that discriminate among economic participants and induce biased resource allocation. In theory, political risk is a

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4 Political instability is a property of political risk, in which the former refers to unexpected or unforeseen changes in leadership succession or government policy, resulting in subjective uncertainty about the possibility of political events occurring, and the latter is a more objective measurement of the possibility of this occurring.
factor that acts beyond traditional economics as an interference of political institutions in market-based economies. It is expected to adversely affect cash flows, and is thus one of the most important challenges underlying the FDI decisions of MNEs.

According to Aharoni (1966), business executives rank political instability as the most important variable, apart from market potential. However, in the abundant literature on FDI, only a handful of studies have engaged in actual empirical investigation of political risk as a related variable. Among these, Benacek et al. (2014) examined the risk associated with socio-political institutions and governance, defined as political risk. They employed a panel regression technique to pool significant clusters of data in a systematic framework, and tested for autoregressive processes in the variables. Based on the study of 35 European countries from 1995 to 2008, the results confirmed that institutions, social governance and political risk are important factors in FDI determination. The countries analysed in this study were at varying stages of economic and institutional development; thus, investors’ reactions were related to the institutional situation of the host country, and dependent on national economic policies.

However, empirical studies by Cleeve (2008) and Mhlanga et al. (2010) examined political and civil freedom indexes, yet obtained no conclusive results. This aligned with earlier work by Levis (1979), who employed two proxies for political stability and obtained mixed results. Other studies have also indicated no consensus. For example, Bennett and Green (1972) found that US direct investments were not affected by political instability in recipient countries in any significant way, while Wheeler and Mody (1992) found political risk to be insignificant in explaining US FDI. Additionally, and more surprisingly, a study by Tuman and Emmert (2004) found that a poor human rights record and military coups d'état actually influenced positive US FDI flows, while
Mhlanga et al. (2010) found that higher risk countries attract more FDI in southern Africa.

Although political risk is frequently thought to influence FDI decisions, the empirical results appear to be ambiguous—largely due to the lack of consistent quantitative estimates of this qualitative phenomenon. Moreover, political instability is a complex concept, and no proxies are available to capture all aspects of this determinant.

3.1.11 Related variables. In essence, this exhaustive literature review indicates that FDI flows cannot be solely determined by the conventional factors of production, such as physical and human capital accumulation and technological progress. More in-depth explanations shift away from pure economics and explore an interdisciplinary approach in order to determine the additional factors that influence investment decisions. The possibility for other related variables to determine FDI appears almost limitless in the increasingly integrated macroeconomic setting. However, the most frequently mentioned variables are trade, infrastructure, economic risk in the host country, language, education, legal systems and reporting standards. In general, higher economic growth reflects improvement in productivity and development. Thus, improvements in the above factors will increase growth, lower economic and political risk, and result in a more attractive and stable climate for foreign investors.

An attempt at a more comprehensive review by Assunção et al. (2011) highlighted the following FDI determinants:

- the determinants that are associated with the location dimension of the OLI paradigm are infrastructure, human capital, economic stability and production costs
- the determinants that are associated with the new trade theory are market size, market growth, the openness of the economy and factor endowments
• the determinants associated with the institutional approach are corruption, political instability, institutional quality, and financial and fiscal incentives. (see Assunção et al. [2011] for complete summary tables).

Another interesting literature review of FDI determinants by Bitzenis (2003) provided a ‘universal model of theories determining FDI’ (see Figure 3.1), which does not contain any new considerations, but reviews and connects the main aspects of the existing theories, thereby presenting a broad picture of the effects and potential gains of an FDI project for a company.
Figure 3.1. Universal model of theories determining FDI. Source: Bitzenis (2003).
This literature review provides comprehension of the relativity of each theory, with some viewed as ‘static’ and some as ‘dynamic’. Static theories examine only the determinants that result in the decision of FDI, while dynamic theories also incorporate the effects of FDI on the host country, on the transition process to a market economy, and on MNEs. Generally, these direct and indirect effects are examined in the context of a political economy, through the evolution of the firm and its interaction with the host industry and host country. Since every country offers different motives and incentives for investment and has different obstacles and barriers, which all undergo considerable change over time, MNEs choose the country that maximises the possibility of success for their investment plan (Bitzenis, 2003). Given that all the operations of MNEs have one main purpose—to generate profit—the universal model connects all FDI theories by considering the way they assure profits for the company. However, as globalisation and economic integration are not static and evolve over time, so do economic theories and models. Given that this paper by Bitzenis was written in 2003, the universal model does not comprise the newer theories of FDI; thus, henceforth, this model may be expanded and improved by including new theories developed over time.

In essence, Bitzenis (2003) attempted to connect the main aspects of the dominant theories in one universal model to demonstrate that there is no theory that is all-encompassing by itself. This is simply because it is not possible for all countries around the world to offer the same opportunities and same conditions for MNEs to act at the same time (Bitzenis, 2003). Moreover, the opportunities a country can offer change through time, and the different ways in which MNEs evaluate the concept of globalisation are not valid for the general theories of FDI. Therefore, it is unsurprising to find ambiguities and conflicting results in the FDI literature. In order to avoid the problem of misleading generalisations, many studies focus on specific countries to
determine FDI. For example, Bitzenis (2003) succeeded in determining the most applicable theory for Bulgaria for 1989 to 1999 through conducting a large number of questionnaires and interviews with almost 100 foreign companies operating in Bulgaria.\(^5\) Thus, the current study also aimed to use the most applicable theory for the chosen country of study (Thailand) during a selected period (1990 to 2013) in order to answer the research questions via using statistical analysis of the research results.

### 3.2 FDI Determinants in Thailand

Given that the literature on FDI is extensive, the purview of this study needs to be clarified. First, while this thesis discusses the determinants of FDI, this analysis did not constitute the core of the study. It was assumed that foreign investors are predominantly motivated by international rent-seeking under the conventional profit-maximising theory, and the main FDI determinants are GDP, wage rate, interest rate, exchange rate and net exports. Second, the empirical analysis was not intended to verify all possible reasons for the increase in Thailand’s FDI, but to find the major determinants as a common background of FDI inflows into Thailand over the period 1990 to 2013.

Following the review of empirical studies, this section attempts to identify Thailand’s FDI determinants based on the model taken from Daly and Tosompark (2011). The following specification was built according to the discussion in the former literature:

\[
\text{FDI}_{it} = f (\text{RWA}_{it}, \text{RIR}_{it}, \text{ER}_{it}, \text{NX}_{it}, \text{RGDP}_{it})
\]

(1)

where:

- FDI = the annual flow of real FDI inflow to Thailand

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\(^5\) See Bitzenis (2003) for details.
• RWA = real wage average
• RIR = interest rate spread (deposit-lending rate) as a ratio of US spread
• ER = real exchange rate (local currency unit)
• NX = Thailand net exports
• RGDP = real GDP/capita.

The log-linear form of Equation (1) is:

\[
\ln FDI_{it} = \alpha + \beta_1 RWA_{it} + \beta_2 \ln RIR + \beta_3 ER_{it} + \beta_4 \text{Dummy} + \beta_5 \ln NX_{it} + \beta_6 \ln RGDP_{it} + \varepsilon_t
\]

(2)

Internal shocks and natural disasters can have a huge effect on the economy, while external shocks may bias study results since domestic economies have become closely linked to the global market. Thus, this study included a dummy variable to reduce the effect of the 2008 global financial crisis (GFC) and the severe flooding in Thailand in 2011. In this dummy variable, 1 = crisis and 0 = no crisis.

Table 3.1

FDI Determinants in Thailand Estimation Results

<table>
<thead>
<tr>
<th>Variable</th>
<th>Coefficient</th>
<th>Standard error</th>
<th>T-statistic</th>
<th>P-value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Constant</td>
<td>-16.21719</td>
<td>3.4650</td>
<td>-4.68</td>
<td>0.000***</td>
</tr>
<tr>
<td>RWA</td>
<td>1.744313</td>
<td>0.5624</td>
<td>3.10</td>
<td>0.007***</td>
</tr>
<tr>
<td>RIR</td>
<td>-0.072024</td>
<td>0.6882</td>
<td>-1.05</td>
<td>0.311</td>
</tr>
<tr>
<td>ER</td>
<td>1.218902</td>
<td>0.5711</td>
<td>2.13</td>
<td>0.049**</td>
</tr>
<tr>
<td>Dummy</td>
<td>-0.782396</td>
<td>0.1139</td>
<td>-6.87</td>
<td>0.000***</td>
</tr>
<tr>
<td>Net exports</td>
<td>1.591253</td>
<td>0.6496</td>
<td>2.45</td>
<td>0.026**</td>
</tr>
<tr>
<td>RGDP</td>
<td>0.425694</td>
<td>0.3715</td>
<td>1.15</td>
<td>0.269</td>
</tr>
<tr>
<td>No. of observations</td>
<td>23</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>R-squared</td>
<td>0.8960</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Adjusted r-squared</td>
<td>0.8570</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>F (6, 16)</td>
<td>22.98</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Durbin-Watson stat.</td>
<td>2.2432</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Note: Ordinary least squared model. The dependent variable is FDI, spanning 1990 to 2013. The model corrects for serial correlation in the residual using Prais-Winston (1954) transformation.
The regression results showed that GDP per capita (constant prices) has a positive effect on FDI inflow. This confirmed the theory that growing market demand encourages foreign investment. However, the insignificant coefficient signified that the size of the market is not the primary factor for foreign investors to invest in Thailand. This could also reflect that the type of FDI inflow to Thailand is more resource-seeking than market-seeking. The positive and significant result for trade variables, as represented by net exports, confirmed the widespread perception that open economies encourage more confidence and increased FDI, if the size of the export sector is an indication of ‘openness’.

The exchange rate (measured in constant prices of the local currency unit) had a positive effect on the FDI inflow. In this case, appreciation of the currency during the examined period significantly increased the inflows of FDI. According to the aforementioned theories, this suggested that FDI in Thailand may be less concentrated on exports. Although some industries in Thailand are promoted as export-oriented—such as financial institutions, trade, mining and quarrying, services, and manufacturing industries (such as electronics/electrical products and textiles)—the overall image is one of import substitution, with FDI focusing on the domestic market for major agricultural products, investment and real estate. The empirical results confirmed that this is the case for Thailand. However, aside from that, the results could simply be due to the issue of contemporaneous correlation, reflecting how investors’ investment in Thailand leads to greater demand for Thai baht.

The result for real average wage was significantly positive, thereby indicating that FDI is induced by an average wage that has been steadily rising for two decades. As Thailand has been open to FDI for more than four decades and was upgraded to an upper-middle-income country by the World Bank in 2011 (Witt, 2013), investors may
optimistically view an increase in wage rate as an indicator of economic growth and improvement in labour quality. This suitably explains the positive relationship between average wage rate and FDI in Thailand.

The cost of capital in terms of interest rate spread showed a negative, yet insignificant, result. This ambiguously suggests a negative influence of local interest rate on FDI inflow. Considering that MNEs are no longer limited to the local market to finance their business activities, the increasing role of the international capital market may need to be considered to enable better understanding of the relationship between interest rate and FDI.

3.3 Research Contribution

This empirical analysis sought to replicate the work of Daly and Tosompark (2011) with new, updated data. However, the results were slightly different, possibly due to including a dummy variable in this study. Due to data limitations at the time, Daly and Tosompark (2011) was unable to include the effect of the 2008 to 2009 GFC. With updated data, the current study was able to extend the model by including the dummy variable (crisis), thereby filling this gap in the literature. The findings revealed that many factors can positively influence the level of FDI inflow to Thailand. Among these are GDP, net exports, exchange rate and wage rate. In contrast, external instabilities and natural disasters (such as the GFC and severe flooding represented in the model as a dummy variable) had a significant and negative effect on FDI. In terms of accounting for Thailand’s past FDI performance, the empirical results were found to be satisfactory, and aligned with prior expectations based on theoretical concepts. In regard to previous empirical works, the findings appeared to be in consensus, except for minor discrepancies. As with all economic modelling, the results should not be interpreted without considering the limitations.
3.4 Data Limitation and Scopes for Future Research

Despite this study’s best efforts, certain limitations are inevitable, pertaining to the dataset, omitted variables and estimation used. First, the dataset used in this model was the most updated data provided by the Bank of Thailand (BOT). However, it did not cover 100 per cent of total FDI inflows to Thailand due to the lack of available information from small investing partners, such as Laos People’s Democratic Republic (PDR), Cambodia and Myanmar.

Second, the determinant model did not include human capital endowment, government expenditure, investment or political risks (such as corruption, political instability and institutional quality). Other macroeconomic variables (such as inflation rate and unemployment rate) were also omitted because including every single variable would make the model too exhaustive and obscure the results. Future study could generate different findings by incorporate socioeconomic and political changes, such as the coups d'état (1981, 1985, 1991 and 2006) and their repercussions. Such major events can cause structural changes to Thailand’s FDI inflow if the interim government is subject to strict military guidelines, which can decrease investors’ confidence in the long term. Unfortunately, such analysis requires much more data than are currently available in Thailand, and is subsequently unfeasible at this point.

Finally, the data were collected from various sources (the BOT, World Development Index [WDI], National Statistical Office [NSO], UNCTAD and National Economic and Social Development Board [NESDB]), which meant descriptions of the variables were not consistent. Accordingly, the empirical results were predisposed to discrepant definitions and restrictions based on different facts and data criteria. Given that inaccurate data can either overestimate or underestimate the determinants of FDI, these results need to be interpreted with caution.
3.5 Effects of FDI on Host Country

The fact that FDI investors are foreign to the host country causes different effects (economic, political and social) that influence the costs and benefits of FDI. However, it is unclear which costs are borne and which benefits are enjoyed by the home and host countries. To effectively determine the impacts of FDI, researchers must consider both direct and indirect effects on economic growth.

Direct effects occur when affiliates of MNEs are more productive than comparable local firms, resulting in changes in employment, exports and innovations, while indirect effects refer to the spillovers to other local firms and to the rest of the economy, mainly in forms of competition, linkages, skills, and imitation. These externalities can be either positive (technology diffusion, research and development) or negative (competition effect, crowding-out effect or business-stealing effect).

Recognising that FDI does have both direct and indirect effects on economic growth and that evaluating them in isolation can lead to biased estimates and misguided policy outcome, the following section investigates the externalities through a review of literature and empirical evidence in which FDI was found to have some effect on a country’s development.

3.5.1 Effect of FDI on output and growth. ‘Whether FDI can be deemed to be a catalyst for output growth, capital accumulation, and technological progress seems to be a less controversial hypothesis in theory than in practice’ (De Mello, 1999). In theory, the presence of MNEs in developing economies may be beneficial for boosting economic development through technological transfer and capital accumulation. However, it could also be detrimental to growth if dominating MNEs’ activities have a negative influence on the market structure (less competitive), cause a lower rate of
accumulation domestically (profit repatriation) and lead to adverse developments (derogatory transfer pricing and weaker control over economic policy) (Lall, 1977).

Given that the debate of whether FDI inflows are growth-enhancing or growth-restricting in emerging economies remains largely empirical, considerable research has been conducted on the subject, and yielded different results. Early studies on FDI—such as those by Singer (1950), Prebisch (1968), Griffin (1970) and Weisskopf (1972)—supported the traditional view that the target countries of FDI receive very few benefits because most benefits are transferred to the MNEs. Bacha (1974) examined the effects of FDI by US companies on the host country’s growth, and found a negative relationship between these two variables. Saltz (1992) examined the effect of FDI on economic growth for 68 developing countries, and also found a negative correlation between FDI and growth. Similarly, Haddad and Harrison (1993) and Mansfield and Romeo (1980) found no positive effect of FDI on the rate of economic growth in developing countries. De Mello (1999) used both time-series and panel data from a sample of 32 developed and developing countries, and found weak indications of a causal relationship between FDI and economic growth. In a comparative study of FDI and economic growth in India’s and Bangladesh’s economies, Alam (2000) found that the effect of FDI on growth was better in the Indian economy, yet was not satisfactory. Pradhan’s (2002) study in India found that FDI stocks had no significant effect.

It is often argued that FDI causes a ‘crowding out’ effect on domestic capital, which is most likely to occur when MNEs compete with domestic companies for scarce resources, such as skilled labour. Moreover, if foreign firms finance their investment through borrowing in the host country, the host country’s interest rate will rise, thereby causing the effect of FDI on growth to be either insignificant or negative. Carkovic and Levine (2002) in 72 developed and developing countries and Mencinger (2003) in eight
transition economies found that FDI had a negative effect on economic growth. Lensink and Morrissey (2006) incorporated the volatility effects of FDI inflows for 87 countries and found a negative influence on growth.

In contrast, there is also much evidence of a positive effect of FDI on growth. Empirical studies have found that FDI is positively correlated with economic growth, such as in Blomstrom et al. (1992) for 78 developing countries and Borensztein et al. (1998) for 69 developing countries. Zhang (2001) in East Asia and Latin America and Makki and Somwaru (2004) in 66 developing countries also found a strong and positive interaction between FDI, trade and advanced economic growth. Campos and Kinoshita (2002) examined the effects of FDI on growth for 25 Central and Eastern European and former Soviet Union economies. Their results indicated that FDI had a significant positive effect on the economic growth of each selected country. In addition, the studies by Marwah and Tavakoli (2004) in ASEAN 4 countries, Lumbila (2005) in 47 African countries, Lensink and Morrissey (2006) in 87 countries, Feridun and Sissoko (2006) in Singapore and Har et al. (2008) in Malaysia revealed that FDI had a positive effect on GDP growth. Liu (2008) focused on whether FDI generated spillovers that benefited domestic firms in the host country, and also found a positive result. Moreover, the recent study by Faras and Ghali (2009) showed that, for most of the Gulf Cooperation Council countries, there was a weak, yet statistically significant, causal effect of FDI inflows on economic growth.

3.5.2 Effects of FDI on employment and wages. ‘While employment creation is regarded by governments as an important potential contribution that FDI can make to their economies, most analyses of the labour market effects of FDI identify both positive and negative potential effects’ (Jenkins, 2006). Two main arguments supporting the positive effects of FDI on the labour market are derived from previous empirical
studies, which stated that: (i) MNEs are more productive than domestic firms and (ii) MNEs pay higher wages than domestic firms. The conclusion that MNEs are more productive than local firms was reached by Doms and Jensen (1998), Evenett and Voicu (2001), Lipsey (2002), Djankov and Hoekman (2000), Conyon et al. (2002) and Helpman et al. (2004). This can be explained by the concept of ‘ownership advantages’ in the OLI paradigm (Dunning, 1977, 1979, 2000).

In regard to wages, many studies have found that MNEs operating in both developed and developing countries pay higher wages than do local firms (Agarwal, 1980; Aitken et al., 1996; Conyon et al., 2002; Djankov & Hoekman, 2000; Doms & Jensen, 1998; Blonigen, 2005; Huttunen, 2007; Markusen, 1995; Molero & Buesa, 1993). Latorre et al. (2009) offered a few possible explanations for this occurrence:

1. MNEs tend to be more prevalent in sectors that employ a large number of nonproduction workers, thereby increasing the domestic labour demand. Once demand exceeds supply in the labour market, average wage will increase.

2. MNEs pay higher wages to discourage their employees from leaving to work for other firms, and thereby transferring valuable knowledge to other firms.

3. Workers hired by MNEs may be more productive because MNEs may attract the best workers by paying them a higher wage than other firms.

While one of the main attractions for local workers is that MNEs pay higher wages, the effect of MNEs on the average wages of the whole economy is questionable. MNEs’ wages can be above domestic wages due to a negative effect caused by MNEs—that is, the presence of MNEs causes a large fall in average wages, with a disproportionate negative effect on workers in domestic firms. There is also plenty of evidence—both qualitative and quantitative—showing that the presence of foreign firms
does not necessarily lead to increased job opportunities because these firms use labour-saving technology and employ mainly well-educated workers by paying them higher wages (Athukorala, 1993; Sousa, 2001; Martins, 2004). This causes an increase in wage inequality.

Consistent with the theoretical model, Feenstra and Hanson (1996) found that FDI increased the wages of skilled workers relative to unskilled workers in Mexico during the 1980s. Similarly, an empirical study by Aitken et al. (1996) in Venezuela found that FDI had a negative and significant effect on the average wages of workers employed by local firms, while, in Mexico, FDI had the same negative (although insignificant) effect. Feliciano and Lipsey (1999) could not find a significant effect on the average wages in the manufacturing sector in Mexico; however, for the rest of the studied sectors, average wages increased. Lipsey (2002) summarised the scarce available evidence on the effect of FDI on average wages, and declared it to be positive in the sense that MNEs’ entry increased wages. A more recent study by Huttunen (2007) also found that foreign acquisitions led to higher wages in Finland, and that the wage increases were higher for more educated workers (Latorre et al., 2009). Overall, this field requires further research—a task that would be facilitated by improved availability of data on labourers’ skills and corresponding wages (Markusen, 2002).

3.5.3 Effects of FDI on import, export and the BOP.

FDI in many poor countries causes balance of payment deficit due to e.g., huge import activity they engage in, large repatriation of profit to parent companies, and a huge lose on national revenue due to too-long tax holiday and exemption or inappropriate report of real business profit. (Seila, 2011)

There is the same bidirectional argument in the case of FDI and the export nexus. Petri and Plummer (1998) argued that it is unclear whether FDI causes exports,
or exports cause FDI. Hsiao and Hsiao (2006) asserted that exports increase FDI by paving the way for FDI through gathering information about the host country, which helps reduce investors’ transaction costs. In addition, FDI may reduce exports by serving foreign markets through establishing production facilities in these markets. In contrast, some regard the positive effect of FDI on export performance as one of the main benefits for the host country. This conclusion was supported by Zhang (2005), who found that FDI has a positive effect on China’s export performance, and that FDI’s effect on exports is much larger than that of domestic capital. However, foreign investors’ commitment comes at a price because they expect high returns on high-risk investments. In the long term, this leads to capital outflows in terms of profit remittance and interest payments, which are reflected in the positions of the BOP, as shown in Table 3.2.

Table 3.2

**FDI’s Effect on the BOP**

<table>
<thead>
<tr>
<th></th>
<th>BOP</th>
</tr>
</thead>
<tbody>
<tr>
<td>Capital outflows</td>
<td>Capital inflows</td>
</tr>
<tr>
<td>Imports</td>
<td>Exports</td>
</tr>
<tr>
<td>- Intermediate goods for local assembly and sale</td>
<td>- Final goods for global markets</td>
</tr>
<tr>
<td>- Machinery for local production facilities</td>
<td>- Intermediate goods for global markets</td>
</tr>
<tr>
<td>- Investors’ global products for local sale</td>
<td></td>
</tr>
<tr>
<td>Service imports</td>
<td>Service exports</td>
</tr>
<tr>
<td>- Fees for licenses and other services</td>
<td>- Tourism and business travel receipts</td>
</tr>
<tr>
<td>Capital exports</td>
<td>Capital imports</td>
</tr>
<tr>
<td>- Profit remittance</td>
<td>- Initial equity investment</td>
</tr>
<tr>
<td>- Interest payments</td>
<td>- Loans from parent to affiliate</td>
</tr>
<tr>
<td>- Repayment of loans</td>
<td></td>
</tr>
</tbody>
</table>


### 3.5.4 Effects of FDI on trade flows

In recent years, scholarly attention has focused on the effect of international trade and FDI on economic growth in the host
The economy through productivity effects. For example, Helpman (1984) and Helpman and Krugman (1985) argued that, if countries are asymmetric, a capital-abundant country provides headquarter services in a labour-intensive country through FDI, in exchange for finished varieties of differentiated goods. Thus, FDI generates complementary trade flows from labour-intensive countries. However, if countries are symmetric, there is a substitution effect, and capital-intensive goods are exchanged for labour-intensive goods. Kojima (1973) analysed whether FDI is trade oriented or anti-trade oriented, and reached inconclusive results. It is not easy to determine whether MNEs tend to generate trade deficits or surpluses in the host economy. The relationship between FDI and trade is said to be related to the predominance of vertical or horizontal MNEs. There are entire bodies of research that address this in detail; however, this is not the focus of this thesis (e.g. Blonigen, 2001; Hanson et al., 2003; Markusen, 2002).

3.5.5 Effects of FDI on productivity (spillover). ‘Many studies on spillovers have focused on whether transference of new technologies from MNEs affects domestic firms’ productivity. In this respect, the results are fairly ambiguous’ (Tanna, 2005). One of the most studied effects of FDI is that of spillovers—the positive or negative externalities arising from the presence of MNEs. One type of externality is the arrival of new or better products, introduced by foreign affiliates, from which consumers benefit. Apart from the advanced techniques and knowledge that MNEs bring, Jean et al. (2002) and Rutherford and Tarr (2008) also found that FDI inflows improve welfare by increasing the product range available to consumers. However, empirical evidence casts doubts on whether such positive spillover effects exist in developing countries.

Aitken and Harrison (1999) found evidence of negative spillovers on domestic productivity in Venezuela for the period 1976 to 1989. Many later studies reached similar conclusions, including those by Djankov and Hoekman (2000) in the Czech
Republic, Kathuria (2000) in India, Kugler (2001) in Columbia, Damijan et al. (2003a) in eight transition economies, Smarzynska (2002) in Lithuania, Hu and Jefferson (2002) in China and Lopez-Cordova and Meissner (2003) in Mexico. All these studies found insignificant or negative externalities associated with FDI. In fact, most studies published since 1999 have found negative or insignificant spillovers (Harrison & Rodriguez-Clare, 2010). A recent meta-analysis of 32 studies by Wooster and Diebel (2010) confirmed that ‘it is quite possible that intra-sectoral spillovers from FDI in developing countries are largely nonexistent’. This contradicts reviews by Accolley (2003) and Ranjan and Agrawal (2011), who found evidence from previous research that indicated that developing and transition countries recorded a strong investment jump through the advantages they gained after FDI penetration, including technological transfer, industrial reorganisation, and development of labour force skills, which all influence production, wages, price levels and the entire economy.

For transition economies, the evidence is even less clear. Liu (2002) in China, Yudaeva et al. (2000) in Russia and Sinani and Meyer (2002) in Estonia found positive effects, while other studies found negative effects in Bulgaria, Romania (Konings, 2001) and the Czech Republic (Djankov & Hoekman, 2000). However, these studies in transition economies have employed relatively small datasets of selected subindustries, or short time periods. Hence, the overall evidence does not support the proposition of intra-industry productivity spillovers (Meyer, 2003).

For Eastern European countries, studies seem to provide more significant results. Djankov and Hoekman (2000) found a negative effect of the presence of MNEs on domestic firms acting in the same sector in the Czech Republic. Also for the Czech economy, Damijan et al. (2003b) detected no horizontal spillovers and found negative spillovers for R&D-intensive firms, whereas Kinoshita (2001) found positive spillovers
for R&D-intensive firms. In the remaining six transition economies studied by Damijan et al. (2003b), positive intra-industry effects were obtained only for Romania; however, Konings (2001) found negative spillovers for the same country. All these studies used the same methodology (panels), examined firm-level data and analysed a very similar period—approximately 1992 to 1998.

Other studies are noteworthy for their particularly careful econometric approach. Aitken and Harrison (1999) found evidence of negative spillovers on domestic firms’ productivity in Venezuela. FDI reduced the output of these firms, which made them produce at less efficient points of their declining average cost curve, thereby reducing their productivity. Haskel et al. (2007) obtained evidence of positive horizontal spillovers in the United Kingdom. However, these positive spillovers did not seem large enough to justify the amount of money spent by the government to attract MNEs. In Lithuania, Javorcik (2004) found positive spillovers through backward linkages, and no evidence for horizontal or forward linkages. This suggests that vertical spillovers may be more likely than horizontal spillovers. These latter analyses, together with analyses covering a wider spectrum of studies (e.g. Barba Navaretti & Venables, 2004; Crespo & Fontoura, 2007; Görg & Greenaway, 2004), showed unclear, and even negative, evidence of MNEs’ effects on domestic firms’ productivity.

Through a careful review of the literature, Herzer (2012) attempted to list several explanations for these negative and statistically insignificant results, as follows:

1. foreign firms reduce the productivity of domestic firms through competition effects
2. MNEs have lower marginal costs and attract demand away from domestic firms, thereby forcing them to reduce production and move up their average cost curves (Aitken & Harrison, 1999)
3. if MNEs purchase fewer inputs locally than do the domestic firms they displace, the MNEs’ backward linkage effect is negative, and FDI leads to a decrease in input variety and host country productivity (Rodríguez-Clare, 1996)

4. MNEs may be able to effectively protect their firm-specific knowledge, so that no knowledge spillovers between MNEs and local enterprises take place (Görg & Greenway, 2004)

5. domestic firms using outdated production technology and low-skilled workers are unable to learn from MNEs

6. spillovers may occur vertically, rather than horizontally (intra-industry), through relationships that are overlooked in conventional spillovers studies.

3.5.6 Conditions of spillover effects. ‘The beneficiary country requesting adequate human capital, economic stability, market liberalization to benefit from long term capital flows’ (Bengoa & Sanchez-Robles, 2003).

Macroeconomic evidence from aggregate cross-section studies has generally suggested that, in accommodating environments, FDI is likely to have a positive effect on generating economic growth. Previous research by Borensztein et al. (1998) argued that FDI has a positive growth effect when a country has a highly educated workforce that allows it to exploit FDI spillovers. While Blomstrom et al. (1994) found no evidence that education is critical, they argued that FDI has a positive growth effect when a country is sufficiently wealthy. Alfaro (2003) found that FDI promotes economic growth in economies with sufficiently developed financial markets, while Balasubramanyam et al. (1996) emphasised trade openness as crucial for inducing the positive growth effects of FDI. A recent literature review of the relationship between FDI and economic growth found that capital flows can have a significant effect on the
host economy, depending on the nature of financial markets and the host country’s level of human capital and technological absorptive capacity (Carp, 2012). Other empirical research at the macroeconomic level emphasised that FDI externalities are influenced by the absorptive capacity of the host country and are limited by local conditions, financial market development and education levels (Azman-Saini et al., 2010; Johnson, 2006; Ponomareva, 2000; Yudaeva et al., 2003).

Moreover, Alfaro (2003), Marwah (2004) and Vu and Noy (2009) reached the same conclusion regarding a positive correlation between FDI and economic growth in the manufacturing, primary and services sectors. Blomstrom and Kokko (1996) and Agarwal et al. (2007) emphasised the requirement of human capital, economic and financial stability, and a certain degree of market liberalisation as conditions for FDI to generate positive effects on the economy. In addition, recent studies by Salman and Feng (2009) and Misztal (2010) indicated human resources development, capital formation and the degree of local market competitiveness as the main contributors to FDI effect on growth.

In a review of the determinant factors of FDI spillover, Crespo (2006) summarised that the magnitude of the spillover effect depends on the following factors:

1. absorptive capacity and technological gap (the effects increase with the technological gap)
2. regional effect—geographical dimension (the effects decrease with distance)
3. domestic firm characteristics (the effects decrease with export capacity, and with the size of the domestic firm)
4. FDI characteristics—culture, society, legal differences, language, level of technology, modes of technology transfer, degree of ownership of investment project, distance, sectoral structures of FDI, preferential trade
agreements and so forth (the effects increase with improvement and higher sophistication of these factors)

5. other factors—trade policy environment, different production processes, intellectual property rights, training provided by MNEs, restriction on labour mobility and intensive use of intermediate inputs by MNEs. Finally, macroeconomic findings may be subject to bias in their coefficient estimators and standard errors due to simultaneity bias, country-specific effects, and the routine use of lagged dependent variables in growth regressions. Thus, careful reassessment of macroeconomic evidence is recommended.

3.5.7 Effects of FDI on technology diffusion. Findlay (1978) postulated that FDI would promote economic growth through its effect on technological progress. Various new growth theorists also viewed FDI as one of the factors explaining output growth, and have stressed the importance of knowledge spillovers or technology transfer in addition to capital formation (Balasubramanyam et al., 1996; Borensztein et al., 1998; Das, 1987; De Mello, 1999; Din, 1994; Kim & Seo, 2003; Liu et al., 2002; Rodriguez-Clare, 1996; Shan, 2002).

Borensztein et al. (1998) developed an endogenous growth model that measured the influence of FDI’s technological diffusion on economic growth in 69 developing countries, and found that FDI inflows positively influenced economic growth. Makki and Somwaru (2004) stated that, according to recent endogenous growth theory, FDI can be growth advancing if it results in increasing returns in production through spillover and technological transfers via diffusion processes. In addition, Easterly et al. (1994) argued that technology transfer depends on the diffusion process, which can occur through four modes: (i) transfer of new technologies and ideas, (ii) high-tech imports, (iii) foreign technology adoption and (iv) level of human capital.
Finally, in his recent study of the spillover benefits of FDI during the last four decades, Mumit (2008) reaffirmed the general theory that only when a certain threshold level of human capital exists can FDI contribute positively to economic growth through technology diffusion. Interestingly, he also found that it is generally the growth of human capital, rather than the level of human capital, in the host economy that interacts strongly with FDI to produce positive externalities. This has important implications for developing countries because they can compensate for their lower levels of human capital stock by substituting it with higher rates of human capital growth.

3.5.8 Effects of FDI on human capital (local training and R&D). A major element of technology transfer is the training of local employees at all levels of the organisation, from low-skilled manufacturing operatives, to supervisors, to technically advanced professionals and top-level managers (Blomstrom & Kokko, 2002). Although there is sufficient evidence that MNEs invest more than do local firms in training and staff development (Meyer, 2003), the process and circumstances under which MNEs train foreign staff, as well as the extent of benefits created by this training, are still lacking discussion.

Endogenous growth models (Lucas, 1988; 1990; Mankiw et al., 1995; Romer, 1986, 1987) state that FDI contributes significantly to human capital, such as managerial skills and R&D. MNEs can have a positive effect on human capital in host countries through the training courses they provide to their subsidiaries’ local workers. Kwan et al. (1999) emphasised the role of the learning process through FDI in the growth of a country. Training courses influence most levels of employees, from those with simple skills to those who possess advanced technical and managerial skills. R&D activities financed by MNEs also contribute to human capital in host countries, thereby
enabling those economies to grow in the long term (Balasubramanyam et al., 1996; Blomstrom & Kokko, 1998).

3.5.9 Effects of FDI on market structures. Market structure is another important area that is almost overlooked in the discussion of FDI effects. Only a handful of studies consider how the presences of MNEs influence the host economy’s market structure. Existing studies have found that the effects can be either pro-competitive or concentrated. Specifically, FDI can promote competition and reduce price-cost mark-ups, or can ‘crowd out’ less efficient domestic firms and turn the market into a more oligopolistic structure (Ferrett, 2005). Markusen and Venables (1998, 2000) and Markusen (1997, 2002) summarised that the survival of the firm (MNEs versus domestic) depends on several factors, including the relative endowments and size of countries, level of transport costs, and firm-level and plant-level economies of scale. Therefore, ultimately, as with most effects of FDI, whether or not MNEs crowd out domestic firms and significantly alter the host country’s market structure is an empirical matter. However, as aforementioned, empirical studies on this are scarce and complicated (Navaretti & Venables, 2004).

Nevertheless, some attempts can be found. For example, Co (2001) derived a complex interplay between previous levels of concentration, the type of FDI undertaken (Greenfield versus Brownfield) and the timing of adjustments in the levels of concentration after the entry of MNEs to the US economy. In Ireland, Barrios et al. (2005) found that the pro-competitive effect first dominates, but is gradually outweighed by positive externalities. Sembenelli and Siotis (2005) found that, in R&D-intensive sectors, positive spillovers result in an increase in margins after the entry of MNEs, thereby leading to a more concentrated market structure. Bernard and Jensen
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(2007) analysed US data and found that single-plant firms have a higher probability of failure than do multi-plant firms and MNEs.

Finally, market structure can change as more domestic investors are crowded out due to foreign firms’ higher wages, easier conditions of credit accessed in the domestic financial market, share of the domestic market taken away from their local counterparts, and superior technology. This causes domestic firms to exit the market due to their inability to compete (Seila, 2011).

3.5.10 Effects of FDI on the environment. The literature on the social and environmental effects of FDI has developed largely separate from the literature on economic effects, with neither management scholars nor mainstream economists appearing to have a particular interest. While FDI is influencing many aspects of the host society, research has thus far focused on economic variables. The effect of MNEs on the social and natural environment of host economies can be positive or negative (Chudnovsky & López, 2002). Some authors have argued that the transfer of contemporary, environmentally-friendly technology and production processes by MNEs will improve the standards in the host economy. This is known as a ‘pollution halo’ effect, whereby foreign investors introduce environmentally-friendly technology that diffuses locally. In addition, there is empirical evidence that foreign investors are more efficient in using energy (Eskeland & Harrison 1997)—an important aspect of environmental outcomes. Christmann and Taylor (2001) also found that firms’ international linkages contribute to their adaptation of industry self-regulation standards. However, other studies, such as Hettige et al. (1996), have found that local community pressure is more important than ownership in explaining environmental performance (Zarsky, 1999).
In contrast, other scholars are concerned that MNEs may choose to transfer outdated technology to locations with less stringent environmental regulations. This is known as the ‘pollution haven’ effect, which has become a major concern in environmental circles. MNEs seek to evade stringent environmental standards in their home countries and relocate to a ‘pollution haven’, thereby triggering a ‘race to the bottom’ in environmental standards. The empirical evidence has suggested that escaping environmental regulation is not a substantive motivation for relocating production because compliance costs for most firms are small relative to the total costs of production, and legal changes in developing countries have narrowed the regulatory gap that may have existed in the 1970s (Dasgupta et al., 2002; Jaffe, 1995; Zarsky, 1999). However, possible relocation is occasionally used as an argument by MNEs to bargain with governments.

Studies of actual pollution in overseas affiliates have had to operationalise environmental outcomes by using a single indicator as the dependent variable, which is problematic for a complex construct such as environmental issues. Case studies have provided a more rounded picture of the environmental influence of specific projects, and their evolution over time (Gentry, 1998). They have highlighted particular problems in specific contexts, such as the danger of monocultural plantation for exported food products. However, there are too few such studies to enable a more general conclusion.

### 3.5.11 Effects of FDI on income inequality

In terms of income inequality, there is a strong argument that FDI can exert a negative effect on the economic growth of recipient countries. The dependency school theory argues that foreign investment from developed countries is harmful to the long-term economic growth of developing nations. It asserts that developed nations become wealthy by extracting labour and other resources from developing nations. It also argues that developing countries are
inadequately compensated for their natural resources and are subsequently sentenced to conditions of continuing poverty. This type of capitalism based on the global division of labour causes distortion, hinders growth and increases income inequality in developing countries (Bornschier, 1980; O’hearn, 1990; Stoneman, 1975). Further, Solow’s (1956) neoclassical growth models typically ascribe negligible long-term growth effects for FDI inflows and, with the usual assumption of diminishing returns to physical capital, these inflows can only have short-term effects on the level of income, and leave long-term growth unchanged.

**3.5.12 Effects of FDI on national welfare and poverty reduction.** Similarly, there are opposing sides to the argument regarding FDI’s effects on national poverty alleviation. Chowdhury and Mavrotas (2006) stated that FDI has potentially desirable elements that affect the quality of growth, with significant implications for poverty reduction. It may reduce the adverse shocks to the poor that stem from financial instability, and help improve corporate governance. Further, FDI generates revenue that may support the development of safety nets for the poor (Klein et al., 2001).

However, Reis (2001) pointed out that, due to the nature of FDI, profits are likely to transfer to foreigners, which will decrease welfare to the extent of crowding out local firms. Similarly, since the work of Brecher and Alejandro (1977), it has become well known that an inflow of foreign capital may reduce real income if the capital-intensive import-competing sector is protected by a tariff, and the capital income is repatriated. In his study, Dutt (1998) contended that high levels of profit repatriation and other practices, such as transfer pricing, will result in any new FDI being lower than existing capital outflows, which means that national poverty will worsen, rather than be alleviated.
Additionally, the effect of FDI on national welfare also depends on the type of FDI. Contrary to the classical view that Greenfield investment does not necessarily add to the domestic capital stock, Carp (2012) suggested that this type of FDI will ultimately have a significant effect on the welfare of the host country because it creates new production capacities, new work places, new consumers, new taxpayers, and increased participation in the privatisation process, thereby having a positive effect on the economy. In contrast, Brownfield investment involves foreign investors taking over an enterprise, and signifies a crucial decrease in the number of jobs. This aligns with earlier studies by neoclassical growth theorists. For example, de Mello (1997) concluded that FDI does not contribute to capital formation or growth in the neoclassical growth framework if it takes the form of mergers and acquisitions, and if the proceeds of the sale of assets are fully consumed. In such a scenario, FDI merely represents a transfer of existing assets from domestic to foreign hands, rather than an infusion of additional or complementary capital (Agosin & Machado, 2005).

3.5.13 Effects of FDI on local competition. ‘Foreign entry usually increases competition … is increased competition good or bad for local firms and for consumers?’ (Meyer, 2003). From an economic perspective, increased competition benefits consumers through lower prices or higher product quality. Wang and Blomstrom (1992) and Glass and Saggi (1998) emphasised the importance of competition. There is also some empirical evidence that supports the idea that FDI promotes the competitiveness of local firms. Blomstrom (1994) found positive evidence of this in Mexico and Indonesia, and Smarzynska (2002) found positive spillover from supplying to foreign customers in Lithuania. However, foreign investors may come to dominate the domestic industry, especially if the technological gap between them and their local competitors is large. While this may benefit consumers in terms of lower prices or better quality
products, local firms may be crowded out (Meyer, 2003). In line with this argument, Aitken and Harrison (1999) identified negative spillovers in their empirical study to be a result of the ‘market stealing effect’. Thus, it seems that a positive effect of FDI on competition will only occur if local firms are strong enough to compete with MNEs; otherwise, foreign entry may lead to local firm exit. This is where governments must play a crucial role in determining the outcomes of FDI by designing the most practical FDI policy to benefit foreign investors, but not at the expense of local firms.

3.6 Summary of Empirical Evidence on the Effects of FDI

‘The conclusion reached after several empirical studies on the relationship between FDI and economic development is that the effects of FDI are complex’ (Denisia, 2010). While there is no doubt that FDI affects both home and host countries, the empirical results are ambiguous. In general theory, FDI is regarded a generator of employment, high productivity, competiveness and technology spillovers. For less developed countries with an accommodating environment, FDI yields higher exports and access to international markets and international currencies, as well as being an important source of financing and substituting bank loans.

However, recently, these assumed merits of FDI—particularly the kinds of incentives offered to foreign firms in practice—have been questioned. It has become apparent that, in many cases, FDI is not without a cost. Lipsey (2001) highlighted two different perspectives, with differing outcomes. From a macroeconomic perspective, FDI is a particular form of capital flows across borders, from countries of origin to host countries, which is found in the BOP. From a microeconomic perspective, FDI is explained by the motivations for investment across national boundaries from the investor’s perspective. Therefore, while a macro-level study examines variables such as capital flows and stocks and revenues obtained from investments, a micro-level study is
usually concerned with the consequences for investors (in the country of origin and host country) of MNEs’ operations, rather than investment flows and stocks (Lipsey, 2001). Fuelling this debate is the fact that empirical evidence for FDI generating positive spillovers for host countries is ambiguous at both the micro and macro levels (Alfaro, 2003). Empirical evidence from Cave (1996), Borensztein (1998) and Lipsey (2002) supported the idea that FDI leads to positive spillovers and subsequently contributes to economic growth. However, FDI may crowd out local enterprises and have a negative effect on economic development. In a recent survey of the literature, Hanson (2001) argued that there is only weak evidence that FDI generates positive spillovers for host countries. In a review of micro data on spillovers from foreign-owned and domestically-owned firms, Gorg and Greenwood (2002) concluded that the effects are mostly negative.

Additionally, firm-level studies of particular countries have often found that FDI does not boost economic growth, and frequently found no positive spillovers from foreign-owned to domestically-owned firms (Aitken & Harrison, 1999; Blomstrom, 1986; Haddad & Harrison, 1993). Country-specific analyses of less developed countries have indicated negative effects of FDI due to profit repatriation, with new FDI usually being lower than capital outflow (Dutt, 1998), reduction in real income (Brecher & Alejandro, 1977) and general decrease in welfare (Reis, 2001). Previous studies that have found negative or insignificant spillovers include Aitken and Harrison’s (1999) empirical analysis in Venezuela, Djankov and Hoekman (2000) in the Czech Republic, Kathuria (2000) in India, Damijan et al. (2003a) in eight transition countries, Smarzynska (2002) in Lithuania, Hu and Jefferson (2002) in China and Lopez-Cordova (2003) in Mexico. Previous studies that have reached a negative conclusion (taking into account the host countries’ level of education and economic and commercial
development) include Durham (2004) for 80 countries from 1970 to 1980 and Kholdy (1995) for 10 East Asian countries. A more recent study by Harrison and Rodriguez-Clare (2010) also reached the same conclusion from a broader review of the literature since 1999. This agreed with a meta-analysis of 32 studies by Wooster and Diebel (2010), who found that it is possible that intra-sectoral spillovers from FDI in less developed nations are non-existent. Lipsey and Sjoholm (2001) summarised that, in some countries, researchers have found evidence of positive spillovers in some industries; however, country-specific and industry-specific factors seem so important that the results do not support the overall conclusion that FDI induces substantial spillover effects for the entire economy. In conclusion, firm-level studies have not implied that FDI accelerates overall economic growth (Carkovic & Levine, 2002).

For developing countries, the belief that FDI is a driver of economic growth and development is based on the expectation that developing countries can ‘learn’ from developed countries. Romer (1993) suggested that, for developing countries that wish to gain from developed countries, or at least keep up with their growth, one of the most important and easily implemented policies to incentivise foreign firms to close the idea gap is to let them profit from doing so. Thus, governments of poor countries can help their residents by creating an economic environment that offers adequate reward to MNEs that bring ideas from the rest of the world and implement them with domestic resources.

What one can conclude from these studies is that, despite their different assumptions, data, methodology, specified variables and outcomes, most tend to support the dependent relationship of FDI with all variables of study, and no relationship should be rejected outright. Thus, the next appropriate step is a specified analysis at the country level. In the following chapters, this study focuses on FDI in ASEAN as the chosen
region, and Thailand as the chosen country of study. Specifically, Chapter 4 provides a qualitative study with an insight to FDI experiences in ASEAN and Thailand.
Chapter 4: Assessment of Thailand’s FDI Experience in the Global Context

4.1 Introduction

Based on the theoretical framework from chapter 2, this chapter highlights the importance of the research subject—that is, the role of FDI as a driver of growth and the key to economic development. The main focus is how FDI fits into the global economy, and its implications for individual countries. This chapter considers the institutional arrangement of the Thai economy and its FDI-related policies in terms of various economic effects, as indicated by the previously discussed FDI theories. Of equal importance is a review of previous FDI performance and trends in ASEAN and specifically Thailand.

A review of the literature of Thailand’s FDI appears to indicate that Thailand has largely failed to undertake the necessary measures to move up the value-added chain. Thus, it is important to investigate what instigated the sharp drop in Thailand’s competitiveness during the past few years. Therefore, the rest of the chapter is dedicated to qualitatively analysing Thailand’s international competitiveness in the global market, with reference to the World Bank’s Global Competitiveness Report (GCR). In addition, it examines the country’s competitive advantages and current constraints by using a strengths, weakness, opportunities and threats (SWOT) analysis, and offers suggestions for future development.

4.2 The Role of FDI in the Global Economy

Driven by globalisation, the contemporary world economy is characterised by rising free trade and capital flows, significantly low tariff barriers, increased manufacturing and service outsourcing, higher competitive pressure, shortened product
and technology lifecycles, increased FDI share for emerging markets, and the growing presence of MNEs and FDIs. For over two decades, the role of FDI has been widely perceived as a growth-enhancing factor, especially for developing countries. Since the mid-1980s, these countries have adopted a more liberal policy towards FDI by significantly lowering restrictions on FDI, and extensively offering tax incentives and subsidies that have resulted in a significant influx of MNEs, which has led to increased foreign capital and potentially higher growth. These actions were taken with the confidence that FDI promotes faster economic expansion by enabling FDI-receiving host countries to raise investments that are higher than the level of their domestic savings. Importantly, the entrance of MNEs allegedly leads to more advanced techniques, increased levels of R&D expenditure, and the use of advanced skills and advanced managerial expertise, which lead to better technology and innovation, and thereby higher growth in developing economies (Moura, 2010).

Interestingly, the current overview of global FDI observed two trends emerging in 2011 to 2013—decreasing FDI inflows for developed countries, and increasing FDI inflows for developing countries, which indicate a growing problem of global imbalance (see Figure 4.1). The substantial fall in global FDI flows is mostly due to investors’ uncertainty about the weakening macroeconomic environment (lower growth rates for GDP, trade, capital formation and employment), higher expected risk arising from the eurozone crisis, the US fiscal cliff, recent changes of government in a number of major economies in 2012, and broad-based policy changes with implications for FDI. Total world FDI has also been negatively affected by slower growth in China, Europe, Japan and Brazil; political instability in the Middle East; policy uncertainty in the US; and previous natural disasters, such as the earthquake and tsunami in Japan and major floods in Thailand.
Some recovery was seen in the following year, with the World Investment Report highlighting outstanding performance by developing countries for 2012 to 2013, driven by increasing cross-border merger and acquisitions by foreign firms that hoped to prevail under the changing economic conditions. In the first half of 2012, developing countries continued to strengthen their position, and attracted more than 50 per cent of global FDI inflows for the first time in history. In fact, while global FDI recorded a fall of 18 per cent to US$1.35 trillion in recent years, developing countries have surpassed developed economies, which account for only 42 per cent of global FDI flows (World Investment Report, 2013).

![Figure 4.1. Global FDI inflows for developed, developing and transition economies, 2000–2012 (US$ billions). Source: UNCTAD (2013).](image)

The change in the structure of FDI inflow over time is one of this study’s main interests, as demonstrated in Figure 4.2, which was compiled using data obtained from World Bank’s WDI database. The graphs present the global share of net inflows of FDI by region, measured in current US dollars, for 1972, 1992 and 2012.
The graphical presentations of the data above clearly indicate the outstanding growth of FDI inflow to the East Asia and Pacific region over time, increasing from approximately 13 per cent in 1972, to 23 per cent in 1992, to 31 per cent in 2012. This is mainly due to the growing financial market, economic development and effective market liberalisation in the region, particularly in developing economies,\(^6\) which recorded GDP growth (excluding China) at 6.2 per cent in 2012—up from 4.5 per cent in 2011. In East Asia and the Pacific, overall economic management has been effective

\(^6\) According to the World Bank’s definition, developing East Asia and the Pacific includes China, Indonesia, Malaysia, the Philippines, Thailand, Vietnam, Cambodia, Laos PDR, Mongolia, Myanmar, Timor-Leste, Fiji, Papua New Guinea, the Solomon Islands and other island economies in the Pacific.
in dealing with the global economic crisis, thereby allowing the region not only to remain resilient and sustain growth, but also to catch up with Europe and Central Asia in terms of FDI inflow. However, despite this positive progress and optimistic outlook, in terms of internal development, these countries urgently require further investment in sectors that generate the widespread benefits of local job creation and increased productive capacity (Harvie & Lee, 2002). Therefore, promoting FDI for sustainable growth and poverty reduction remains the general objective in the developing world.

The challenge for policymakers now is to maximise their strengths and address short- and long-term issues with suitable policies in order to achieve constant growth and development of the region. The World Bank suggested that developing countries need to manage strong capital inflows by maintaining an appropriate macro policy mix, sufficient flexibility in exchange rates and macro-prudential policies. Further, most countries could increase productive capacity by investing in infrastructure and human capital that could pave the way for sustainable growth (World Bank East Asia Pacific Update, 2013).

4.3 FDI in ASEAN

As the world trading environment rapidly changes, trends in globalisation and the regionalisation of trade become increasingly apparent. As in other regions of the world, Asia’s regionalisation is largely considered more constructive than harmful for global free trade. The regional forming of selected Asian countries into ASEAN is of a particular interest to this thesis because ASEAN was first established in Thailand. In addition, ASEAN economies are largely characterised by their export-led and FDI-led development strategies, and thus have significant implications for the Thai economy, especially in terms of influencing FDI flows. ASEAN countries today are widely acknowledged as comprising one of the world’s most dynamic regions, with strong
economic growth. The development of ASEAN over time has been demonstrated by the trade flow among ASEAN and major economic partners, as shown in the figure below.

Figure 4.3. Trade among ASEAN and major economic partners (US$ billions). Source: Prakash and Isono (2012).

Figure 4.3 represents the changing trade structure in ASEAN countries, China, Japan, India, the European Union and the US in 1990, 1999 and 2009. The red arrows indicate trade flows that have increased more than four times since the previous period. The figure indicates that, towards the end of the 1990s, ASEAN’s intra-trade increased significantly and exceeded the trade between Japan and ASEAN. Notable changes include obvious expansions in intra-ASEAN, ASEAN–China and ASEAN–India trades, while Japan’s dominance as a supplier of parts and components began to fade, as did the importance of the US as the final destination of exports.

Based on advice from the World Bank, for over two decades, ASEAN member countries have collectively engaged in intra-regional market liberalisation in order to attract more global investors and promote the region as a competitive production hub.
Attracting FDI has been a key objective of this regional project. Members of ASEAN are rich in natural resources and are major world producers of rubber, tin, copra, palm oil, petroleum, coal and timber (Wibowo, 2013). Although these countries were originally resource-based and competing as exporters of primary products in agriculture and minerals, they rapidly industrialised their economies in the early 1970s to reduce their dependence on exports of primary products and imports of manufactured products (Robertson, 2008). The current sectoral characteristics of ASEAN FDI reflect the preferences of direct investors for manufacturing and services industries (POCS, 2015).

The following section examines the recent trends in FDI in ASEAN countries, and the effectiveness of the ASEAN investment schemes. This is done to assess ASEAN’s policy for liberalisation and effectiveness in improving regional growth and development.

4.3.1 History and trends. Established in Bangkok, Thailand, in 1967, ASEAN was initially formed for geopolitical reasons among five country members: Indonesia, Singapore, the Philippines, Malaysia and Thailand. The original goals were nation building and regional cooperation, motivated by a common fear of communism and foreign domination in the 1960s. The regional goals included upgrading the economy; enhancing growth, social progress and cultural development; reinforcing the peace and stability of the region; and assisting its member countries by providing opportunities for diplomatic discussion of their differences.

In 1992, ASEAN started to enter the free trade area in goods as a result of competitive threats from the North American Free Trade Agreement and European Single Market. Several investment initiatives were proposed to strengthen ASEAN as an attractive investment location. The most significant attempt at economic cooperation in

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7 Presently, ASEAN comprises 10 member countries: Brunei Darussalam, Cambodia, Indonesia, Laos PDR, Malaysia, Myanmar, the Philippines, Singapore, Thailand and Vietnam.
the area of FDI was the ASEAN Investment Area (AIA), which was established at the fifth ASEAN summit in Bangkok in December 1995 (Pupphavesa, 2008). ASEAN leaders agreed to extend AIA to cover FDI from outside, as well as inside the ASEAN region. The Framework Agreement was signed by the ASEAN Economic Ministers on 7 October 1998, and entered into force on 7 April 1999. Cambodia joined accession to the AIA agreement on 30 April 1999—about three weeks after it came into force—so that the AIA extended across all 10 ASEAN countries. This framework was created to enhance the process of FDI policy liberalisation, promotion and harmonisation across ASEAN member countries. AIA offers investment support for five sectors: manufacturing, agriculture, fishery, mining and quarrying (Nurridzki, 2015).

At present, the latest development of the ASEAN initiative is the ASEAN Comprehensive Investment Agreement (ACIA), which entered into full force in March 2012 to combine and replace the AIA and ASEAN Investment Guarantee agreements. The main objective of the ACIA is to provide investors with an improved framework for regional production and investment activities. A free and open investment environment is promoted through combining and expanding the agreements between the ASEAN member countries. As the region has grown over the years, ASEAN initiatives continue to improve and strengthen intra-Asian capital flows. Of particular interest in this regard has been the rise of intra-regional FDI flows initiated by Japanese multinationals, followed by companies from high-income economies, such as Hong Kong, Korea, Singapore and Taiwan, and, more recently, the rise of investments by Chinese and Indian companies around the world, and particularly in the rest of Asia. This pattern traces the old ‘flying geese model’, which will be further discussed alongside the political economy context in Chapter 5.
Another significant phenomenon is the rise of China and India in the early 2000s, which accelerated ASEAN into the liberalisation of services trade and investment flows. Presently, the region is undertaking an early phase of economic integration, known as the AEC. The ASEAN Summit in October 2003 agreed to progress into an AEC by 2015 for the ASEAN 5 and by 2020 for the ASEAN CLMV (Cambodia, Laos PDR, Myanmar and Vietnam). This economic community was formed due to concerns that Southeast Asia will be overtaken by China and India, particularly in terms of FDI inflows, which appeared to be diverting away from ASEAN towards China in the early 2000s. With its advantages in size, relatively low-cost and well-educated workforce, increasing wealth, location and outward-looking policy stance promoting FDI incentives, China has emerged as a major regional power. It increasingly competes with ASEAN in local and third markets. In 2002, China received US$53 billion worth of FDI inflow, compared to ASEAN’s US$14 billion (UNCTAD, 2003).

Moreover, the ASEAN countries also faced the threat of FDI being diverted away from the region as a result of the enlargement of the European Union, whereby an increasing share of European FDI was shifted to the European Union’s new member states, rather than to ASEAN countries. By establishing AEC, ASEAN aimed to integrate the national markets of its own member states, and potentially increase regional GDP by at least 10 per cent (or US$50 billion) and reduce operational costs by up to 20 per cent (McKinsey Consultants, 2003).

Over the years, the trend in globalisation and increasing competition saw ASEAN speed up the process of trade liberalisation under the ASEAN Free Trade Area (AFTA). A fast-track scheme was developed for accelerated integration towards the AEC. The specific roadmaps of the ASEAN Sectoral Integration Protocols have

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8 The AFTA is a trade bloc supporting local manufacturing in all ASEAN countries, signed on 28 January 1992 in Singapore by Brunei, Indonesia, Malaysia, the Philippines, Singapore and Thailand.
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identified 11 priority sectors: agro-based products, air travel, automotive, e-ASEAN, electronics, fisheries, healthcare, rubber-based products, textiles and apparel, tourism and wood-based products. Further, ASEAN strongly supports the liberalisation of trade in goods, services and investment; facilitation of trade and investment; and promotion and monitoring of priority sectors. This is because a free and open investment regime is considered key to enhancing ASEAN’s competitiveness in attracting FDI and intra-ASEAN investment in order to ensure dynamic development of ASEAN economies.

Recent developments include official negotiations in 2012 with Australia, China, India, Japan, New Zealand and Korea under a Regional Comprehensive Economic Partnership Agreement, focusing on promotion, protection, facilitation and liberalisation of investments. This agreement will be open for accession to any AFTA partner. The objective of this agreement is to create a liberal, facilitative and competitive investment environment in ASEAN. Following all the aforementioned measures taken by ASEAN, the outcome has been somewhat satisfactory for FDI, as shown in Figure 4.4. This figure presents the annual FDI inflow from 1990 to 2012, which indicates an increasing trend in ASEAN’s FDI share compared to the European Union, China and India.

**Figure 4.4.** FDI Inflows for ASEAN, the European Union, China and India, 1990–2012.

Despite some criticisms regarding the relevance of the ASEAN initiatives (Wibowo, 2013), their success is evident. Since 2009, the ASEAN region has gained relative importance as a magnet for FDI, with a combined nominal GDP exceeding US$1.5 trillion, and being ranked as the ninth-largest economy in the world (ASEAN Secretariat, 2009). Continuous high levels of FDI inflows were noted during 2010 to 2011, signalling recovery from the effect of the global economic uncertainty of the previous years (UNCTAD, 2014). However, the region’s outstanding performance is not a result of equal participation by its member countries. The largest contributor is Singapore, which is the regional hub of international investments and prime driver of intra-ASEAN investments (UNCTAD, 2014). Researchers have taken interest in ASEAN’s policies and strategies for promoting FDI, and their relevance in terms of the final effects of FDI on economic growth and development for its member countries.

4.3.2 Empirical evidence. As researchers and investors begin to pay more attention to the ASEAN region, tracking its progress in the area of FDI requires empirical evidence. Mirza et al. (2004) assessed the degree to which FDI resulted in growth and poverty reduction in ASEAN countries after the 1997 AFC, and found that the macroeconomic effect of FDI on growth and development in ASEAN was considerable and unambiguous, especially in terms of absolute poverty reduction. At the microeconomic level, the authors conducted interviews with top MNE executives in ASEAN, and found that most MNEs appeared to be unaffected by the formation of AFTA or its prospects. The results showed that, even a decade after AFTA was launched, ASEAN as a region or market was not a reason for investing. The most important factors influencing investment, as stated by the respondents, were labour cost and quality (24 per cent), government policies and incentives (16 per cent), market size
(14 per cent) and prior business connections (13 per cent). Thus, the prospect of a larger market or regional market was not the focus for MNE investment. Only one of the 22 respondents viewed a regional market as positive. Nevertheless, the study suggested that AFTA may not have been fully materialised at that time.

A later study by Hattari (2008) found that inflows of FDI between ASEAN countries increased with larger regional market sizes due to the stronger regional ties among ASEAN members. Observing bilateral FDI flows between ASEAN, China and India for 1990 to 2005, the data indicated that intra-ASEAN FDI flows intensified after the 1997 AFC, with mass flows concentrated between Singapore and its neighbouring countries—particularly Thailand and Malaysia. Similarly, Rajan (2008) used bilateral FDI flow data for 15 developing Asian countries from 1997 to 2004/2005 to investigate the trends and drivers of intra-Asian FDI flows. While these flows were substantial, the study suggested that they were not necessarily intensifying. Given that a large part of these flows pertains to bilateral flows between Hong Kong and Mainland China, and that developing Asia is investing extensively overseas, this suggests that there are relatively more investments outside the region.

Several studies have attempted to evaluate the effectiveness of ASEAN schemes and enacted policies. Plummer and Cheong (2009) questioned the relevance of AIA in terms of its effects on FDI inflows to ASEAN. The idea was that the effect of AIA has implications for foreign investors who are responsive to political and institutional changes in their investment decisions. Using both descriptive and econometric methods, the study found that, apart from a setback caused by the 1997 AFC, the FDI performance for the ASEAN region has been remarkable overall, if unevenly contributed. Specifically, the study found that ASEAN FDI is dominated by Singapore, and that the sectoral distribution of FDI has changed in some member countries—
namely, Malaysia, Singapore and Thailand. The study implied that rapid recovery and the restored competitiveness to the region as a production platform after the crisis indicate the effectiveness of both trade and investment policies in ASEAN, and therefore support ASEAN’s plan to form the AEC. The study further recommended that ASEAN members maintain a stable and secure environment for FDI by harmonising FDI policies and reducing bureaucracy and transaction costs. Moreover, to enhance the region’s competitiveness and build a strong investment pillar for the AEC, the member countries need to join to reduce the negative lists in the investment schemes (such as AIA) and ensure that respectable cooperation exists in the region.

Pupphavesa (2008) discussed investment liberalisation and facilitation as an integral part of regional economic integration. The study asserted that ACIA will progressively liberalise ASEAN member countries’ investment regimes to achieve free and open investment by ensuring that the liberalisation is consistent with member countries’ national agendas and economic readiness. It argued that, while the benefits of liberalisation can be shared by all ASEAN countries, there will be losers who resist and protest liberalisation. Similarly, Aldaba (2009) commented on the benefits of AEC caused by regional financial integration and cooperation among the ASEAN member countries. Deeper global financial integration in the medium to long term is considered beneficial for ASEAN, and cooperation among its members is deemed important for improving their national financial systems. Specifically, effective policy dialogue and surveillance processes are expected to reduce the volatility and risks associated with capital flows, and create a more conducive environment for capital account liberalisation. However, some difficulties lie in the region’s absence of an independent, professional organisation that can prepare relevant analyses of such measures. Further, the ‘ASEAN way’ that respects ‘consensus and non-interference in others’ domestic
affairs’ appears to be a common obstacle to ensuring forthright and effective policy discussions (Aldaba, 2009). The study suggested that it would be preferable for ASEAN to focus on developing a more transparent, comprehensive and open forum that allows each member country to jointly participate in crafting measures for capital inflows, and develop their financial systems accordingly.

Uttama (2009) explored regional integration as a determinant of FDI, empirically testing FDI flows in the US and five ASEAN countries (Singapore, Malaysia, Thailand, Indonesia and the Philippines) using panel data for 15 industries, from 1995 to 2007. The results were positively significant, especially for vertical and complex vertical FDI. Another study by Uttama (2011) empirically investigated the existing long-term relationship between FDI, intra-industry trade (IIT) and economic growth in ASEAN. Using panel data from 1985 to 2008, the study employed cointegration and a generalised method of moments test to investigate how changes in inward FDI and economic growth affect IIT. Considering the spatial effects, the findings indicated a significant relationship between FDI, IIT and economic growth. Thus, the ASEAN Framework Agreement on Trade and Investment was found to be effective, and any enacted policies that enhance FDI in ASEAN were strongly supported.

Other recent studies have examined the ASEAN global profile to determine suitable policy recommendations to help the region find its appropriate role in global politics and the economy. Prakash and Isono (2012) found that the region’s focus after the conclusion of FTAs was shifting towards market access, trade, investment, tourism, services, science and technology (S&T), human resource development and technology transfer. Political and security issues have gained importance as ASEAN strives to maintain balance in the region, while dealing with issues of economic inequality and
development gaps. From an economic perspective, the study highlighted the improved facilitation of trade by lowering behind-the-border trade barriers, and enabling continued liberalisation of services and investment as important bridges between ASEAN countries and the rest of the world. From a political perspective, the study recommended that ASEAN should promote cohesion and help its countries realise the objectives of the AEC. Prakash and Isono (2012) stated that, by taking on this responsibility, ASEAN can play a central role in shaping how the regional security architecture evolves to maintain peace, stability and growth in the region.

Wibowo (2013) presented a more dubious view of the relevance of AEC. The main concern arose from the existence of the ASEAN–China FTA (ACFTA). Some economists remain cautious of China, arguing that an economic threat exists as a result of the sheer size and dynamics of China’s economy, and its growing ability to flood the market with low-priced products. Soesastro (2003) and Wong (2006) argued that ACFTA, together with the ASEAN + 3 and AEC forums, might be the impetuous of a powerful East Asian future economic integration (Wibowo, 2013). In this light, AFTA may appear doubtful as a natural trading bloc, since interregional trade has contributed more to ASEAN’s economic growth than extra-regional trade during the last three decades. Hence, there is a possibility that AFTA and the scheduled AEC may result in larger trade diversion effects. The study concluded that, while external FTA may induce ASEAN countries to trade more externally than internally, it may occur at the cost of intra-trade within ASEAN, and the relevance of AEC must be reconsidered. Thus, for the AEC implementation to be successful, it must be accompanied by complementary policies and programs, especially at the national level. Member countries should continue to enhance their competitiveness in investment and trade by developing world-
class infrastructure; skilled and productive workers; innovative capabilities; and an agglomeration of efficient suppliers, competitors, support institutions and services.

Tu (2012) empirically analysed the role of FDI technology spillover effects in the development patterns of ASEAN, and found evidence of technology spillovers in ASEAN that significantly promoted economic development in host countries. This study emphasised the important role of human capital accumulation above the threshold level, and suggested that ASEAN countries should strengthen investment in education to attract higher skilled workers. Otherwise, the inflow of FDI is likely to simply use the local cheap labour force, erode the market share of domestic firms, and thereby hinder economic development (Tu, 2012).

In the attempt to determine the effectiveness of ASEAN in promoting investment for the region, Masron (2013) investigated the effect of AFTA and AIA by using data from 1998 to 2009 for ASEAN 9. Corresponding to Masron and Nor (2013), who hypothesised the potential crowding out effect from large foreign capital influx, Masron (2013) found that the development of local entrepreneurs in ASEAN was inferior to their international counterparts. The empirical results obtained from the fully modified ordinary least squares test showed that the AIA had a positive effect on regional FDI; however, there was a lack of attention given to developing regional investors to be the primary players in the region. Thus, while there is no doubt of the importance of AIA and AFTA for the long-term economic development strategy of ASEAN members, the full benefit of this establishment will not be realised if individual countries lack national policies that support local entrepreneurs to become the ultimate promoters of regional prosperity and stability. Accordingly, one way for member countries to maximise the benefit of AIA is to prioritise the development of local capacity. The study concluded that, as AIA is established as a regional aspiration to
promote greater development and stability, it may not automatically produce the expected outcomes. Hence, every member of ASEAN must formulate and implement national-specific economic policies that are well designed to cater for the needs of national entrepreneurs in order to grow step-by-step.

Recent trends show that there is an increased focus on the issue of FDI quality versus quantity. From an economic perspective, the direction of FDI flows is far less relevant than the quantity and quality of the flows. The goal of trade and investment cooperation between developing countries is to increase intra-regional shares; however, the basic advantage of FDI in terms of technology transfer, favourable capital flows and export boost is uneven because there is no set ‘nationality requirement’. This issue is of particular concern for ASEAN, where there is obvious unbalanced development caused by wide disparities in attracting FDI. Plummer and Cheong (2009) found that Singapore dominates as a source of intra-regional FDI, with outward FDI concentrated in two countries: Malaysia and Thailand. About one quarter of all intra-ASEAN FDI is accounted for by Singaporean investment in these two countries. Thus, the role of Singapore in the process of integration and its increasing dominance are reflected in its amount of accumulative share of FDI. This makes it the main driver for intra-regional trade and investment in ASEAN, as shown in Figure 4.5.
Despite some minor concerns, the majority of literature has indicated that a free and open investment regime is central to enhancing ASEAN’s competitiveness in attracting FDI and intra-ASEAN investment, and accelerating growth and development in member countries. The past performance of the region has been outstanding, and any weaknesses or emerging competitive threats can be reduced with minor adjustments to existing policies. Accordingly, ASEAN continues to promote investment protection, facilitation, cooperation, promotion, awareness and liberalisation.

4.3.3 Regional assessment. A few issues were raised by Prakash and Isono (2012) in a study of firm-level surveys that revealed a few barriers to FDI that exist in ASEAN. The main problem lies in the institutional structure, which could be improved to better facilitate FDI. In particular, there is a general a lack of transparency obfuscated by complicating procedures. However, this can be solved by genuine cooperation that emphasises improving the human resources engaged the FDI procedures, and implementing and enforcing FDI policies in all member countries.

*Figure 4.5. Cumulative FDI net inflow to ASEAN, 2006–2011. Source: ASEANStats Database (2012).*
ASEAN should also exploit existing advantages in its young population and hardworking labour force. As a sizeable emerging region for trade and investment, ASEAN has strong economic standing in the global community. Further, as the economic weight of the world is shifting to East Asia, ASEAN has the enviable position of being in the middle of this region, with a unique opportunity to influence the global political and strategic scenario (Prakash & Isono, 2012). The challenge for ASEAN is to deal with embedded cultural and political barriers to enhance the image of a peaceful and non-threatening bloc. Once this is achieved, ASEAN will be able to collectively use all opportunities offered by its geographical advantage at the centre of regional integration.

In terms of FDI, ASEAN countries can sustain growth by leveraging production networks to facilitate technology transfer. To achieve this, ASEAN countries need to maintain an environment that is friendly to foreign investment by resisting corruption, providing consistent and coherent enforcement of laws and regulations at all governmental levels, and maintaining stable macroeconomic fundamentals (Thorbecke, 2010). Social development will also help the region progress up the value chain more quickly, particularly through investing in human capital and fostering creative industries. Governments should provide sufficient funds to ensure citizens have adequate nutrition, appropriate healthcare and high-quality education. This would help ASEAN member countries advance from labour-intensive production to more complex knowledge-based economies, thereby providing a robust foundation for growth.

Against this backdrop, this discussion now narrows to country level to allow a more in-depth analysis. While several empirical works have presented ambiguous results regarding the FDI–growth nexus for different countries, one clear conclusion is that economic benefits of FDI exist and can contribute to development, yet do not
accrue automatically and evenly across regions, countries, sectors and local communities. A regional scheme such as ACIA by itself does not guarantee that FDI will flow automatically to individual ASEAN countries. Thus, adapting best practices to meet specific national and local conditions is a key determinant of success, which requires rigorous analysis, accurate and valid knowledge of local conditions, continuous study of FDI variables, and updating reliable data that should be performed more frequently for all countries across the region. Well-designed national policies and international investment frameworks are essential for attracting and reaping the full benefits of FDI in developing economies. Host countries need to establish a transparent, broad and effective enabling policy environment to encourage the correct investment mix and be in a position to build their human and institutional capacities to implement them.

However, it is important to point out that policymakers should not regard FDI as a goal in itself. Countries are responsible for creating the conditions and generating the resources needed for their own sustainable and inclusive development. Thus, FDI should take a complementary role in helping the economy achieve the national goals of sustainable growth and inclusive development. Nevertheless, past performance has shown that channelling FDI into productive industries remains a challenge for many developing countries. This problem may be addressed by understanding the country’s characteristics.

The above overview of ASEAN’s FDI has indicated its effectiveness in terms of helping member countries develop sustainable growth through various initiatives. Undeniably, ASEAN formation has had numerous effects on many countries, especially Thailand. Thus, a review of the empirical evidence of Thailand’s FDI is necessary to answer some important questions, including:
• Is the Royal Thai Government’s (RTG’s) confidence in AEC as central to enhance FDI opportunities, growth and development merely one-sided propaganda?

• Is Thailand placing too much faith in the formation of AEC, and subsequently neglecting more important social and economic issues surrounding economic development?

No previous empirical study can precisely answer these questions for the Thai economy; thus, this is one of this study’s main contributions to the literature on FDI and economic growth. As such, the next section shifts the focus to Thailand’s FDI experience and role in ASEAN, followed by a review of past literature on the determinants and consequences of Thailand’s FDI. This highlights Thailand’s failure to undertake the necessary measures to move up the value-added chain. It also attempts to determine what has caused the sharp drop in Thailand’s competitiveness during the past few years.

4.4 FDI in Thailand

The issue of FDI’s interaction with economic growth in developing countries has become increasingly important, capturing the attention of researchers and scholars. Many international investors are seeking advantages in natural resources, markets, technology, industry clusters and cost savings, which makes Thailand one of the most favourable ASEAN destinations for foreign investors (Kinghorn, 2011). However, the main concerns regarding FDI inflow for countries such as Thailand, Indonesia and Malaysia—whose investment focus has been built around cheap labour, rich natural resources and a sizable domestic market—is that they appear to be falling behind their ASEAN competitors. For example, Singapore has been dominating the region by maintaining better attraction for foreign investors, and thereby securing its position in the international market with strong government support, particularly as a technology
and industry hub for different industries (such as medical devices and logistics). This is illustrated by Figure 4.6, which presents a country comparison of inward FDI for the ASEAN 5 countries. The inferior performance of Thailand, Indonesia, Malaysia and the Philippines may indicate relative weaknesses in their governments’ policies for sustainable development, compared to Singapore.

![Figure 4.6. Inward FDI for ASEAN 5 countries (2002–2012), measured as a percentage of GDP. Source: WDI (2013).](image)

Importantly, aside from the overall superior business environment of Singapore, there is increasing competition from the CLMV countries in terms of labour costs and the availability of resources and technology. This calls for serious reflection on the key factors that can enhance FDI inflows for Thailand.

In terms of development, Thailand’s strategy has been strongly market oriented and open to trade and investment flows with the rest of the world since the late 1950s, achieving satisfactory growth performance over time. In terms of the social indicators of economic progress, there have been significant improvements in the wellbeing of
Thailand’s population, for factors such as life expectancy, infant and maternal mortality, and literacy. However, this also means there is a high chance of a future ageing society, in which shortages of labour supply will become a hindrance to growth. Meanwhile, the current concern is the performance of the education system, which is chronically deficient, as well as environmental problems and institutional failures in resource management that have not been completely eliminated. Therefore, reform is needed in several areas, particularly in terms of political and corporate governance, regulation of industry, and education and health systems. Although acknowledged, these persisting problems remain largely ignored by policymakers and bureaucrats. Instead, the government has been more focused on promoting FDI and attracting investors via the formation of ASEAN and AEC. Of greatest concern for Thailand is that, while trying to compete with its neighbouring countries, the basic foundations of the economy have been overlooked, and sectors with high potential (such as the agriculture, education and health industries) have been neglected.

Given this background, this research identified several country studies that have focused on FDI flows, with an emphasis on the determinants and consequences of FDI and FDI policies. The importance of this research is reflected in governments implementing FDI policies that aim to induce positive flows, complementary to the country’s economic conditions. However, despite the considerable amount of research performed on the topic to date, Thailand—a relatively small economy compared to countries such as China—shows limited comprehensive economic analysis of its FDI experience. This thesis proposes to make up for this deficiency in the literature. Specifically, previous research has indicated that, despite developing countries’ various attempts to improve their rates of economic growth and increase their standard of living via internationalisation, many of these attempts have not proven successful. In the case
of Thailand, there has been debate about how governments can influence and regulate FDI in the manner that is most beneficial to the country’s sustainable growth and development. Thus, this thesis examines the effects of FDI on Thailand’s economic growth in the context of a political economy approach. The main areas examined are: (i) whether FDI has had a positive effect on the Thai economy; (ii) whether the Thai government has been successful in achieving better economic growth through implementing its policies; (iii) if not, which areas have reported failure, which possible alternative policies exist, and what are Thailand’s expected future outcomes.

4.4.1 History and trends. Historically, Thailand has depended heavily on the inflows of FDI from the US and Japan, which have accounted for at least 50 per cent of all FDI inflows. This geographic pattern of FDI has changed remarkably since Japan searched for production bases abroad to escape the appreciating home currency in the early 1980s. Recent trends show that Thailand’s FDI is geographically diversified, with new partners including ASEAN, the EU-15, Australia and New Zealand. Thailand has been open to the international economy since the 1990s, as indicated by both the increase in FDI and rising GDP (see Table 4.1). Thailand is among a small group of developing economies engaged in investment and trade liberalisation by exhibiting very high trade orientation, embracing foreign investors, and offering low average tariffs.

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9 The EU15 comprise of the following 15 countries: Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, Netherlands, Portugal, Spain, Sweden, United Kingdom.
Table 4.1

**Economic Indicators of Thailand (1993–2012)**

<table>
<thead>
<tr>
<th>Year</th>
<th>Population (millions)</th>
<th>GDP at current price (US$ m)</th>
<th>GDP per capita (US$)</th>
<th>Inflation rate (per cent)</th>
<th>Exchange rate (bath/US$)</th>
<th>Net FDI (US$ m)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1993</td>
<td>58.07</td>
<td>125,011</td>
<td>2,152.77</td>
<td>3.29</td>
<td>25.32</td>
<td>1,804.04</td>
</tr>
<tr>
<td>1994</td>
<td>58.49</td>
<td>144,308</td>
<td>2,467.18</td>
<td>5.21</td>
<td>25.15</td>
<td>1,366.44</td>
</tr>
<tr>
<td>1995</td>
<td>58.98</td>
<td>168,019</td>
<td>2,848.55</td>
<td>5.59</td>
<td>24.92</td>
<td>2,067.94</td>
</tr>
<tr>
<td>1996</td>
<td>59.56</td>
<td>181,948</td>
<td>3,054.75</td>
<td>4.01</td>
<td>25.34</td>
<td>2,335.84</td>
</tr>
<tr>
<td>1997</td>
<td>60.21</td>
<td>150,891</td>
<td>2,506.21</td>
<td>4.06</td>
<td>31.36</td>
<td>3,894.76</td>
</tr>
<tr>
<td>1998</td>
<td>60.90</td>
<td>111,860</td>
<td>1,836.68</td>
<td>9.24</td>
<td>41.36</td>
<td>7,341.80</td>
</tr>
<tr>
<td>1999</td>
<td>61.62</td>
<td>122,630</td>
<td>1,989.99</td>
<td>-4.04</td>
<td>37.81</td>
<td>6,102.68</td>
</tr>
<tr>
<td>2000</td>
<td>62.34</td>
<td>122,725</td>
<td>1,968.54</td>
<td>1.35</td>
<td>40.11</td>
<td>3,365.99</td>
</tr>
<tr>
<td>2001</td>
<td>63.07</td>
<td>115,536</td>
<td>1,831.90</td>
<td>2.07</td>
<td>44.43</td>
<td>5,067.17</td>
</tr>
<tr>
<td>2002</td>
<td>63.80</td>
<td>126,877</td>
<td>1,988.73</td>
<td>0.82</td>
<td>42.96</td>
<td>3,341.61</td>
</tr>
<tr>
<td>2003</td>
<td>64.49</td>
<td>142,640</td>
<td>2,211.87</td>
<td>1.33</td>
<td>41.48</td>
<td>5,232.27</td>
</tr>
<tr>
<td>2004</td>
<td>65.09</td>
<td>161,400</td>
<td>2,478.82</td>
<td>3.13</td>
<td>40.22</td>
<td>5,860.26</td>
</tr>
<tr>
<td>2005</td>
<td>65.56</td>
<td>176,352</td>
<td>2,689.95</td>
<td>4.49</td>
<td>40.22</td>
<td>8,055.35</td>
</tr>
<tr>
<td>2006</td>
<td>65.88</td>
<td>207,089</td>
<td>3,143.24</td>
<td>5.24</td>
<td>37.88</td>
<td>9,454.93</td>
</tr>
<tr>
<td>2007</td>
<td>66.08</td>
<td>246,977</td>
<td>3,737.72</td>
<td>3.45</td>
<td>34.52</td>
<td>11,326.93</td>
</tr>
<tr>
<td>2008</td>
<td>66.20</td>
<td>272,578</td>
<td>4,118.40</td>
<td>3.93</td>
<td>33.31</td>
<td>8,538.34</td>
</tr>
<tr>
<td>2009</td>
<td>66.28</td>
<td>263,711</td>
<td>3,978.91</td>
<td>1.95</td>
<td>34.29</td>
<td>4,853.96</td>
</tr>
<tr>
<td>2010</td>
<td>66.40</td>
<td>318,908</td>
<td>4,802.66</td>
<td>3.66</td>
<td>31.69</td>
<td>9,103.99</td>
</tr>
<tr>
<td>2011</td>
<td>66.58</td>
<td>345,672</td>
<td>5,192.12</td>
<td>4.23</td>
<td>30.49</td>
<td>7,780.01</td>
</tr>
<tr>
<td>2012</td>
<td>66.79</td>
<td>365,564</td>
<td>5,473.75</td>
<td>1.29</td>
<td>31.08</td>
<td>8,616.30</td>
</tr>
</tbody>
</table>


Over the past few decades, FDI inflow to Thailand has accelerated rapidly. There was a large increase in FDI at the end of the 1980s until the late 1990s, from US$489 million in 1987, to US$1,804 million in 1993, to a peak of US$7.3 billion in 1998. This figure decreased slightly for 1999 to 2000 in the aftermath of the AFC in 1997; however, the country recovered with a higher FDI in 2001 than in 1997, which continued to increase over the following years. FDI reached its highest point in 2007, and then declined by more than half in 2009 due to the global economic recession.

Although the amount of FDI has been small, the country’s GNP, exports of goods and services and foreign exchange reserve have grown significantly larger (Boonlua, 2011).
This may imply that FDI will play an increasingly important role in Thailand’s economy in the future.

Given renewed attention to the role and benefits of financial globalisation following the onset of the GFC in 2008, Ito (2009) observed a number of notable distinctions between the 2007 to 2008 GFC and 1997 AFC, and found that solid domestic institutions (especially in the financial sector), swift policy responses and a sound macroeconomic environment with adequate reserves have helped the ASEAN region manage the adverse effects of the GFC. This implies that the recent trend in financial liberalisation has had more benefits than disadvantages for developing Asian countries, particularly Thailand. Nonetheless, rapid financial liberalisation must be accompanied by improved financial supervisory and regulatory mechanisms to ensure the effects of spillovers and financial stability.

4.4.2 Review of the literature. Previous research has found that the net benefits of FDI and their magnitude differ according to the host country’s developmental policy and context. In particular, studies have highlighted several factors that restrict a country from experiencing the full benefits of FDI. For example, Sosukpaibul (2007) emphasised that, in some developing countries, a low level of general education and health, low level of technology in host country enterprises, limited prevailing policy on openness to trade, competition and inadequate regulatory frameworks have created significant barriers to fully embracing the benefits of FDI. Conversely, a higher level of technological, educational and infrastructural achievement in a developing country creates better chances of benefiting from foreign presence in the domestic market. Importantly, the effect of government investment policy on FDI in different sectors differs. For Thailand, Sosukpaibul (2007) found that the significance of government investment policy in FDI for the agriculture and services sectors was low, yet had a
positive sign. Bilateral agreements also appear to be an important factor in attracting FDI for electrical appliances, textiles, agriculture, automotive and services sectors. Therefore, selective government policies can generate higher FDI and stimulate flows of investment. Sosukpaibul concluded that investment promotion policies implemented by governments should be used further. Under an investment promotion policy, labour quality is a key factor for attracting FDI; thus, devoting more of the government budget to developing education may increase the quantity of skilled labour, which is a catalyst for the inflow of appropriate FDI relative to the host’s environment (Sosukpaibul, 2007).

Milner (2004) investigated the effects of Japanese firms and Thailand’s characteristics on the inter-industry pattern of FDI at the firm level, and found that RTG incentives have a significant effect on the cross-industry pattern on FDI. The results also indicated that low labour and setup costs and cultural factors have an insignificant effect on FDI, while stable political conditions have a strong positive influence on FDI decisions. This suggests that government incentives are treated as extra benefits by Japanese MNEs, rather than as a determinant factor. Meanwhile, Boonlua (2011) evaluated the determinants of US and Japanese FDI in Thailand based on a questionnaire survey conducted in Thailand at the beginning of 2011. The study considered six factorspolitical, government regulation, social and cultural, location, financial and market factors—and found that all were significant. The results indicated that the presence of US and Japanese FDI in Thailand was largely influenced by the available infrastructure, relatively low labour and transportation costs, technology provision, abundance of raw materials and supplies, and easy entry to the target market. In addition, cultural and social factors had some influence, including Thai people’s attitudes, beliefs, values, religion, language, communication and manners. The study
recommended developing infrastructure as an essential factor, as well as promoting Thai culture to Western investors, in order to increase the ease of conducting businesses in Thailand and attract further FDI.

In a multi-country study by Chowdhury and Mavrotas (2006), inconsistent results were found in an FDI–growth causality test for Chile, Malaysia and Thailand over 1969 to 2000. Specifically, empirical evidence showed bidirectional causality for Thailand and Malaysia, but unidirectional causality for Chile (GDP caused FDI, but not vice versa). The study argued that the importance of FDI for growth and stability in developing countries under the assumption that ‘FDI causes growth’ may be overemphasised, and concluded that broad policies aimed at improving economic fundamentals may be more important for developing economies than specific policies aimed at attracting FDI.

The diversity found in the FDI literature suggests that studies of FDI should not be static, but should continue to reflect and respond to the key challenges currently faced by policymakers and officials. Consequently, this thesis aims to examine how FDI affects different sectors of the economy. It investigates the Thai government’s recent FDI promotions in different areas. Specifically, it explores the macroeconomic effects of the Thai government’s investment policies on FDI, classified by economic sector (tourism, manufacturing, agriculture, finance and others). The novelty of the thesis is that it endogenously determines policy choices in the political economy framework that recognise the trade-offs between promoting FDI and maintaining a competitive domestic economy with the possible outcomes in attracting sectoral FDI that corresponds to a sustainable development regime.

4.4.3 Thailand assessment. In summary, FDI is an integral aspect of an open and effective international economic system, and a major catalyst for economic
development. However, the benefits of FDI do not accrue automatically and evenly across countries, sectors and local communities. National policies and international investment strategies are important for attracting FDI and reaping its full benefits for development. This raises the question of what constitutes good FDI for development. FDI is beneficial for a country if it supports the host country’s basic national development objectives, such as job creation and productivity growth, while complying with the country’s social, environmental and legal terms. Most importantly, FDI is favourable when it creates positive spillover effects and sustainable linkages with the domestic economy. In order for this to occur, the local government must exhibit transparency in its rules and regulations, and consistency in policy implementation and legal enforcement to ensure good governance.

In the case of Thailand, where domestic legal, competition and environmental frameworks are weak and weakly enforced, the presence of financially strong foreign enterprises may not be sufficient to assist economic development. Thus, the challenge is how to establish a transparent, broad and effective enabling policy environment for investment, and build human and institutional capacities to implement this. As suggested by Gorg and Greenaway (2004), general policies aimed at altering economic fundamentals may be more suitable for Thailand than specific policies for attracting particular investments. Fiscal incentives must be applied with great caution because they tend to reduce government revenues. Instead, increased attention should be directed to the quality of growth as a key determinant of FDI, in conjunction with the quality of human capital, infrastructure, institutions, governance, legal frameworks, and information and communications technology (ICT) and tax systems in Thailand (Chowdhury & Mavrotas, 2006).
4.4.4 Summary. Via an overview of FDI at the global, regional and country level, this chapter has examined some general trends, performances and concerning issues to be considered in this thesis. First, the formation of ASEAN and its various initiatives have been largely beneficial for its member countries in promoting international trade and enhancing FDI. However, the level of benefits extracted from ASEAN schemes differ among member countries, depending on a country’s preconditioning factors, such as infrastructure, technological readiness, capital accumulation, commitment to R&D, level of human capacity and (most importantly) government policies. There is also a noticeable lack of understanding of ASEAN initiatives such as the formation of AEC by Thai people in general. The RTG needs to be more active in educating its citizens to have a more solid understanding of ASEAN and its role, and how it affects the Thai economy as a whole.

In the socio-political context, differences remain imbedded in Thai culture, which has become one of the main hindrances to the country’s development. Cooperation and unity is needed not just between Thailand and ASEAN members, but particularly within the country itself. Internal issues should be dealt with as a priority for Thailand in order to progress to the same level as other advanced economies. Thus, the remainder of this chapter is dedicated to a detailed analysis of Thailand’s international competitiveness in the global market, based on the World Bank’s GCR. The country’s existing advantages and constrains will be put into perspective using SWOT analysis, followed by recommendations for general development in the future.
4.5 Thailand’s International Competitiveness in the Global Economy

**Figure 4.7** Performance of ASEAN members in the 2013 to 2014 Global Competitiveness Index and the 12 composing pillars (rank out of 148 countries).


The Global Competitiveness Index (GCI) is a comprehensive tool annually published by the World Economic Forum (WEF) to measure the microeconomic and macroeconomic foundations of national competitiveness. It is built upon three sub-indices with over ninety variables (Balzaravičienė & Pilinkienė, 2012) that are drawn from several data sources such as the World Bank, the United Nations Educational, Scientific and Cultural Organization (UNESCO), the International Monetary Fund (IMF), and the World Health Organization (WHO). The index evaluates the efficiency of different sectors of the national economies and their contributions to the country’s productivity. It also highlights the strengths and weaknesses of the countries in order to find their comparative advantages and the business investment potential in them.
A recent study by Balzaravičienė & Pilinkienė (2012) considers three most discussed competitiveness indices (Global Competitiveness Index, World Economic Yearbook, European Competitiveness Index), and makes a comparison based on the number of countries covered, main categories, number of key factors, number of key sub-factors, data, weighting, normalization, other methods, etc. According to their analysis, the GCI is globally recognized as an index of country competitiveness and has a couple of advantages over the other indices. For instance, GCI uses hard data and surveys, thus the index is based on both quantitative and qualitative data. These data is always standardized and normalized.

Moreover, GCI is the only index that attempts to rank all economies on a large-scale, which makes it a convenient tool for benchmarking a country’s performance. This gives the GCI an advantage over other competitiveness indices such as the WEF or the European Competitiveness Index, which covers less country and is often limited to a selected area of the globe. There are also other useful indices available, such as the Travel and Tourism Competitiveness Index, but they mostly covers only the related sectors of the economy and therefore fail to give the overall picture of the country’s economic situation.

Lastly, although there may be additional information from other national sources, but they appear to be somewhat restricted, and not as openly accessible as the GCI. It is also expected that the value of similar indexes will differ depending on the data input and range, the type of scientific researches carried out, etc. If this is the case, then comparing competitiveness indexes may be unnecessary. For the purpose of this study, GCI is simply chosen as a tool to measure economic sector’s competitiveness because not only is it one of the most comprehensive and easiest to interpret, but the data is readily available for Thailand.
According to the GCR (2013-2014), Thailand has only achieved a marginal movement upwards in the GCR rankings, from 38th of 144 economies in 2012 to 37th of 148 economies in 2013. Thailand’s future competitiveness may be challenged by the more notable improvements seen in neighbouring countries, such as Indonesia’s improvement by 12 places (now ranked 38th), the Philippines’ improvement by six places (now 59th) and Vietnam’s improvement by five places (now 70th). Analysis has identified that the factors undermining Thailand’s development are political and social unrest; policy instability; extreme bureaucracy; insidious corruption and clientelism;10 and lack of security, reliability and property rights protection. Of greatest concern are the two critical economic foundations of health and education. Thailand’s health status is low, displaying one of the highest human immunodeficiency virus (HIV) occurrence rates outside Africa, while enrolments in and quality of higher education remain uncommonly low. The GCR 2013-2014 report showed that Thailand’s rankings were low for the quality of public institutions (78th) and public health and primary education (81st). Equally crucial to Thailand’s current development, technological readiness remains low (ranked 78th). All these issues require urgent attention if the country is to remain competitive in the global market.

10 Clientelism is a political system in which voters trade political support for various benefits, such as goods and services, or public decision-making processes.
In terms of other development pillars, the country continues to improve in the macroeconomic environment (31st), financial development (32nd) and market efficiency (34th). However, room for improvement remains in promoting domestic competition through higher education and training (66th) and enhancing labour market efficiency (62nd).

4.5.1 The 12 pillars of competitiveness. Given that competitiveness features highly on the economic reform agenda for all economies, the GCR framework was developed to measure a country’s competitiveness based on 12 pillars, and determine the specific areas in which the country needs to improve. This framework ultimately recommends suitable reforms and investments to enhance a country’s competitiveness, which is crucial for economic transformations that complement sustainable growth in the long term.

The World Economic Forum (WEF) defined competitiveness as the set of institutions, policies and factors that determine the TFP of a country. Fundamentally, the level of productivity can indicate a country’s economic prosperity and growth potential by the rates of return obtained through investments and productions. Thus, the concept of competitiveness involves static and dynamic components. Many determinants drive productivity and competitiveness, ranging from the conventional theory of specialisation and division of labour, to a neoclassical focus on investment in physical capital and infrastructure. The importance of education, training and technological progress has also gained economists’ interest over time. These factors, among others, are important for competitiveness and growth, but are not mutually exclusive. This open-endedness is captured in the GCR by including a weighted average that measures different aspects of competitiveness. These factors are grouped into 12

pillars: institution, infrastructure, macroeconomic environment, health and primary education, higher education and training, goods market efficiency, labour market efficiency, financial market development, technological readiness, market size, business sophistication and innovation. Thailand’s stage of development is reflected in Figure 4.10, illustrating the 12 pillars of competitiveness for the year 2013.

![Figure 4.10. Thailand’s stage of development, 2013. Source: WEF (2013).](image)

4.5.1.1 First pillar: Institutions. The quality of institutions is determined by the legal and administrative framework, which has a strong bearing on competitiveness and growth because it influences investment decisions. In an environment where individuals, firms and governments interact to generate wealth, the role of the state essentially determines the speed of the country’s development. According to the GCR (2013-2014), Thailand’s institutions rank 78th of 148 countries, with a low score of only 3.8 out of seven. This poor performance is mostly due to low scores and ranking on public trust in politicians (127th), wastefulness of government spending (107th), business
costs on terrorism (120th) and reliability of police services (109th). Additionally, government indiscretions all lead to higher investment risks and economic costs to businesses, including excessive bureaucracy and red tape, overregulation, corruption, mendacious public contracts, lack of transparency and trustworthiness, inadequate services for the business sector, and political influence on the judicial system. This hinders Thailand’s process of economic development.

4.5.1.2 Second pillar: Infrastructure. Infrastructure refers to a country’s basic physical systems, including transportation, telecommunication, water supply, electrical systems and others. These are predominantly high-cost investments, yet they yield high long-term benefits and are very important to a country’s economic development. The quality of infrastructure determines the effectiveness of a country’s economic function, thereby influencing its FDI location and type of economic activity. Well-developed infrastructure reduces the problem of distance between countries by connecting domestic markets to international markets at a low cost, and helps reduce income inequalities and poverty in many ways. The need for infrastructure network development as an important source of a country’s competitiveness is increasingly emphasised. Businesses depend on abundant water and electricity supplies that are free from interruptions in order to effectively operate without hindrance; thus, infrastructure is one of the factors that determine the level of investment by MNEs after trade liberalisation in both developed and developing economies.

When examining the effects of governance infrastructure on FDI inflows and outflows in 144 developed and developing countries from 1995 to 1997, Globerman and Shapiro (2002) found clear evidence that governance infrastructure (referring to the political, institutional and legal environment) is a significant determinant of both FDI inflows and outflows. Investments in governance infrastructure not only attract capital,
but also strengthen domestic firms and encourage them to invest abroad. Confirming this hypothesis, Ang’s (2008) study in Malaysia from 1960 to 2005 found that expansion of the infrastructure base (measured in terms of government expenditure on transportation and communication) increased inward FDI for the host country. Nourzad, Greenwold and Yang (2014) analysed a panel of 46 countries (including Thailand) and their five-year averages for 1980 to 2000, and postulated that expanding an economy’s infrastructure base can increase the effect of FDI on growth and development above and beyond the direct effect of FDI alone. They argued that enhancing the overall effect of FDI on the standard of living stems from increasing the efficiency with which FDI is used in production and distribution processes, rather than a simple increase of FDI inflow.

Thailand’s focus has recently been on increasing the level of FDI, yet there has been insufficient analysis of the specific links between FDI and infrastructure development, and its effects on national economic growth. According to the WEF’s (2013) GCR ranking, Thailand’s infrastructure competitiveness score is 4.5 out of seven, ranking 47th of 148 countries. A particular downfall appears to be the low quality of railroad infrastructure (ranked 72nd) and low number of fixed telephone lines per population (ranked 96th). In addition to these low indicators, a pressing problem for Thailand is the overcrowded population in urban areas. Although there has been continuous improvement in Thailand’s infrastructure, it is still inadequate compared to the sheer size of the Bangkok cluster. Therefore, another large challenge for Thailand is to distribute new infrastructure projects to smaller cities outside Bangkok, and somehow finance these projects without increasing public debt.

The RTG’s current infrastructure investment program for 2014 to 2020 is estimated as involving two trillion baht, with a focus on a dual track rail, high-speed rail
system and mass transit system in Bangkok. The government plans to fund its seven-year program primarily from the domestic market through government bond issuance, with supplementary funding from its annual budget and retained earnings from state-owned enterprises, public and private partnerships, external borrowing and FDI. However, while infrastructure projects can provide great benefits to host countries, foreign investors may feel reluctant to engage in activities that yield social benefits, while causing risks and possibly lower returns. Therefore, the RTG must take steps to encourage foreign investment in infrastructure.

4.5.1.3 Third pillar: Macroeconomic environment. Although macroeconomic stability alone cannot increase the productivity of a nation, it has significant effects on businesses and the overall competitiveness of a country. An unstable macroeconomic environment reduces the government’s ability to meet its debts and control its budget balance. Running fiscal deficits limit the government’s future ability to react to business cycles and provide services efficiently. The economy cannot achieve sustainable growth under an unstable macroeconomic environment.

Thailand’s macroeconomic stability has captured the attention of the public since the 1997 AFC. The GCR reported that the macroeconomic environment pillar of competitiveness for Thailand is ranked 31st of 148 countries, as measured by government budget balance, gross national savings, inflation, general government debt and country credit rating. The most pressing issue for the RTG is to manage its general government debt, which sat at a substantial 45.27 per cent of GDP in 2014 (World Bank, 2014).
The GCR ranks Thailand 78th of 148 other countries in terms of government debt as a percentage of GDP, presenting it as the main weakness in the country’s macroeconomic environment. This is because the government cannot provide efficient services while obliged to make high-interest payments on its past debts. In addition, running fiscal deficits limits the government’s future ability to react to business cycles, which results in macroeconomic instability, as recently witnessed in advanced economies such as the US and Europe, when their public debt became overwhelming in the wake of the GFC (ILO, 2011).

The RTG has little, if any, financial flexibility under the current revenue to support investments in the transport system and infrastructure, as well as social, healthcare and education policies, due to limited scope for raising domestic loans from both a legal and financial managerial perspective. This presents the government’s dilemma of prioritising development initiatives under both economic and political constrains. It is argued that fiscal space should be relaxed to accommodate additional borrowing in order to finance infrastructure projects, with the potential to create...
productive assets that pay for themselves in the long term. However, at the same time, fiscal space is suggested for higher health and education outlays that will eventually pay for themselves through higher returns to human capital. In either case, the challenge of creating fiscal space faced by governments and their advisers—including international financial institutions such as the International Monetary Fund (IMF)—is to provide resources for worthwhile government spending, without compromising macroeconomic stability and fiscal sustainability.

4.5.1.4 Fourth pillar: Health and primary education. Investment in providing health services is crucial for maintaining a healthy workforce, which directly affects workers’ productivity and subsequently the overall competitiveness of a country. In addition to health, the quantity and quality of basic education significantly affect the efficiency of individual workers. Lack of health leads to lower levels of efficiency and significant costs to business, while lack of basic education constrains business development that allows workers to produce more sophisticated or value-added products and move up the value chain. For Thailand, there is certainly room for improvement in both the number of primary education enrolments (101st) and quality of primary education (86th). According to the 2014 GCR, in terms of the basic primary education and health, Thailand ranks the fourth-least competitive among 10 Southeast Asian countries and 81st overall of 148 countries worldwide, with the most problematic indicators being the number of Malaria cases, number of tuberculosis cases and HIV prevalence in the adult population.

A similar indicator, the Human Development Index (HDI), tracked by the United Nations Development Program (UNDP) covers the key areas of human development, such as life expectancy, schooling and standard of living. Thailand’s HDI has risen steadily for over 30 years. In 2013, Thailand ranked 103rd of 186 countries—
close to the top of the ‘medium human development’ category. The table below shows a brief comparison of Thailand’s 2013 HDI indicators with similar sized countries.

Table 4.2

Thailand’s HDI Indicators for 2013 Relative to Selected Countries and Groups

<table>
<thead>
<tr>
<th></th>
<th>HDI value</th>
<th>HDI rank</th>
<th>Life expectancy at birth</th>
<th>Expected years of schooling</th>
<th>Mean years of schooling</th>
<th>GNI per capita (PPP US$)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Thailand</td>
<td>0.722</td>
<td>89</td>
<td>74.4</td>
<td>13.1</td>
<td>7.3</td>
<td>13,364</td>
</tr>
<tr>
<td>Viet Nam</td>
<td>0.638</td>
<td>122</td>
<td>75.9</td>
<td>11.9</td>
<td>5.5</td>
<td>4,892</td>
</tr>
<tr>
<td>Philippines</td>
<td>0.660</td>
<td>117</td>
<td>68.7</td>
<td>11.3</td>
<td>8.9</td>
<td>6,381</td>
</tr>
<tr>
<td>East Asia and the Pacific</td>
<td>0.703</td>
<td>—</td>
<td>74.0</td>
<td>12.5</td>
<td>7.4</td>
<td>10,499</td>
</tr>
<tr>
<td>High HDI</td>
<td>0.735</td>
<td>—</td>
<td>74.5</td>
<td>13.4</td>
<td>8.1</td>
<td>13,231</td>
</tr>
</tbody>
</table>


Although performing comparatively better than similar sized countries from East Asia and the Pacific—such as Vietnam and the Philippines, which have HDIs of 122 and 117, respectively—it is important to note that there are significant underlying regional disparities in Thailand’s healthcare system.

Figure 4.12. Thailand’s health service disparity. Source: Public Expenditure Review, World Bank (2012).
Addressing regional disparities is important for Thailand not only for social equity, but also for competitiveness and economic growth. As a result of the universal healthcare scheme launched in 2001, the majority of citizens are covered by health insurance, and life expectancy has increased. Nevertheless, there is an ongoing need to develop systems corresponding to social changes, such as rising incomes and the beginning of an ageing society. In addition, the traditional Thai family is under strain—the number of divorces has risen sharply, while almost one third of Thai households are now headed by an elderly person. While the population ages, Thailand is seeking to move to a high-income economy, which requires a larger base of healthy and highly skilled citizens. To achieve greater equity, the World Bank recommends Thailand rebalance its public spending in terms of quantity and quality regionally, and standardise its reporting and monitoring system for service provision (Worldbank, 2015).

4.5.1.5 Fifth pillar: Higher education and training. International experiences emphasise human development as the key to a country’s longer-term competitiveness and sustainable growth. In the development context, all private firms constantly require well-trained and highly educated workforces to sustain their business competitiveness. There is an increasing preference for high-tech-savvy, new-generation workers, who are not only equipped with knowledge of information technology, but can also adapt to dynamic and globalised markets. This desired quality highlights one of the major weaknesses of education in Thailand.

Thailand’s underachievement in education and limited numbers of science and engineering graduates have hindered its innovation from being on par with other ASEAN countries. The existing education system is degraded by lack of credibility,
mostly due to its inward-looking curriculum, which is highly focused on rote learning and discourages critical thinking. These weaknesses allow MNEs to take advantage of low-cost labour without any real competition from domestic firms. Thailand’s quality of higher education has been described as ‘abnormally low’ in comparison with other ASEAN countries (GCR, 2014). This deteriorating status requires an urgent national strategy to reverse the trend; however, efforts to implement educational reforms have been unsuccessful due to political interference and bureaucratic resistance. According to the 2013-2014 GCR, Thailand’s ranking for quality of the educational system is 79th of 148 countries, with secondary education enrolment ranking even lower, in 94th place. In addition to conservative teaching methods, outdated curriculums, underqualified teachers and a low English proficiency, a high percentage of Thailand’s national budget spent on ‘education’ is not invested in improving educational quality and standard, but in expenditures such as bricks and mortar, personnel expansion and welfare.

4.5.1.6 Sixth pillar: Goods market efficiency. Efficient goods markets enable countries to produce and trade a suitable mix of products and services based on their supply and demand conditions. For both domestic and international businesses, strong market competition is essential for enhancing a country’s market efficiency and overall productivity. According to the 2014 Global Competitiveness Index, Thailand scores relatively well for goods market efficiency pillar with a score of 4.7—ranking 34th of 148 countries. This is mostly due to its high degree of customer orientation (15th) and buyer sophistication (25th), which ensure strong demand conditions for market efficiency. However, improvements are needed in the area of agricultural policy costs (ranked very low at 121st), burden of customs procedures (80th) and number of days to start a business (106th). Moreover, the level of trade tariffs as a percentage of duty needs
to be lowered because such protectionist measures can be counterproductive since they reduce aggregate economic activities.

4.5.1.7 Seventh pillar: Labour market efficiency. It is generally accepted that an efficient labour market is crucial for enhancing a country’s economic efficiency and competitiveness. In addition to building a highly educated and well-trained workforce, an efficient labour market ensures all workers are suitably located and offered incentives to maximise their productivity. This means that there needs to be some flexibility in the labour market to the extent that workers can shift from one activity to another at minimum cost, and wages can be adjusted without great social disruption. Thailand’s labour market efficiency ranking of 62\textsuperscript{nd} of 148 countries is somewhat worrying because it reflects a huge fall from 24\textsuperscript{th} in 2010 to 2011. The country’s performance is much worse than that of higher-income countries in Southeast Asia, such as Singapore and Malaysia, in every aspect of market flexibility and efficient use of talent (Lathapipat & Chucherd, 2013). In particular, Thailand needs improvement on flexibility for wage determination and redundancy costs, which rank below average, at 111\textsuperscript{th} and 135\textsuperscript{th}, respectively.

On the surface, Thailand appears to be performing well, considering its significantly low and decreasing unemployment rates, fluctuating below one per cent for the past few years (BOT, 2014). However, this contradicts its reportedly low score on efficiency, which indicates underlying problems in the labour market, as detected by the growing existence of the ‘informal market’. Thailand has a large informal sector that comprises 62 per cent of the total labour force of almost 40 million people (NESDB, 2014). Even in agriculture, the sector has a disproportionately large 62.5 per cent of workers in informal labour.
The Ministry of Labour of Thailand has expressed concerns that, while unskilled and semiskilled labour is in greatest demand, the country has a surplus supply of graduates. Low labour market efficiency signifies a low level of productivity in the rapidly expanding informal sector. As such, Thailand faces the challenge of having a shortage of unskilled and semiskilled labour, arising from its degree-oriented culture and ageing population. According to the ministry’s latest survey, the country is reaching an elderly population of seven million people, which is almost 10 per cent of the total population, and is expected to increase to approximately 25 per cent by 2030 (Ministry of Labour of Thailand, 2013).

From both economic and social perspectives, these trends are concerning for legitimate reasons. Currently, the informal sector accounts for more than 30 per cent of all employment for highly educated workers, which indicates the problem of skills mismatch among this group of workers—possibly attributed to the low quality of education, irrelevant fields of study, or both. First, despite the growing number of highly educated workers, their competency is doubtful. As aforementioned, the outcome of government spending on education tends to be successful in terms of quantity, but the real problem lies in the quality of the education. Despite the rapidly increasing number of secondary and tertiary graduates, a growing proportion of this group is of questionable quality, and rarely accepted by international standards. This not only results in an inefficient labour market, but also limits future growth, particularly in terms of human development.

Second, the new entrants fail to provide desirable skills for formal employers, and subsequently end up in the informal economy, where more jobs are available in retailing and restaurants, but with less productivity and capital invested. Evidence shows that, while technology-based sectors such as manufacturing and medicine have
become increasingly important for upgrading the contemporary economy, Thailand’s university graduates are largely concentrated in the fields of social science and humanities, rather than S&T. As a result, many miss the opportunity to gain skills and experience from working in the more capital-intensive formal sector. The high number of new university graduates experiencing difficulties in securing jobs confirms that Thailand’s education system is not aligned with the needs of local employers. In addition, this situation is worsening over time, as illustrated in Figure 4.13, which compares the rate of unemployment to the level of educational attainment in 2013 and 2014.

Figure 4.13. Unemployment rate by educational attainment level, in July 2013 and 2014. Source: NSO (2014).

Conclusively, labour shortage in quality and quantity has become a major constraint for Thailand’s competitiveness. This situation arose from ineffective planning of the national workforce in both the education and business sector. Firms are reluctant
to make major investments in the face of severe skills shortages in the labour market, while the deteriorating education system, low wage bargaining power of employees and increasing attractiveness of the informal sector encourage declining unemployment and rising informality, which leads to declining wage rates in almost all educational groups (Lathapipat & Chucherd, 2013).

**4.5.1.8 Eighth pillar: Financial market development.** Supported by numerous conceptual and empirical studies, it is clear that the financial market is at the core of the development process. The main functions of a typical financial market are transferring resources from savers to investors, settling payments, managing risks and providing information for financial decision making. True development of these functions can bring real benefits to the poorest members of society by reducing income inequality and providing more opportunities for all. A well-developed financial market enhances growth by providing access to finance for qualified individuals, businesses, governments, infrastructure and trade. In its simplest form, it channels available funds to the most productive areas by allocating risks to those who can best bear them. This ensures better opportunity and income distribution, thereby boosting economic growth and reducing poverty. However, evidence from many developing countries reveals that the benefits of financial development are exclusive due to restricted financial access, which leaves much of the population in a worse position than before. For Thailand, where there is a significant unmet demand for infrastructure funding, the role of the financial market is even more crucial; thus, developing a sound and liquid financial market should be one of the top priorities for improving the country’s competitiveness. Ranking 32nd of 148 with a score of 4.6 of seven (Global Competitiveness Index, 2014), Thailand particularly needs to improve on venture capital availability (41st), soundness
of banks (39th) and legal rights index (89th). A better developed financial system will allow the economy to exploit the benefits of FDI more efficiently.

4.5.1.9 Ninth pillar: Technological readiness. Recent trends show emerging market economies (EMEs) following the development path of advanced economies through enhancing their ICT sectors and promoting ICT adoption in other sectors. This is expected to generate faster growth and enhance developing economies’ international competitiveness and overall economic performance. In this sense, Thailand makes an interesting illustrative case because it is losing its comparative advantage in low-cost production, and subsequently feels pressured to speed up its technological progress to remain competitive. In response, Thailand has become more active in raising competitiveness in the ICT sector by attracting more foreign investment and fostering domestic entrepreneurship. Nevertheless, many areas remain challenged, particularly in terms of uneven development of physical infrastructure across the country, the insufficient skilled workforce, and low R&D expenditures in the ICT sector. These problems are common in many developing countries, and have resulted in a number of studies examining the factors that contribute to the development and competitiveness of ICT sectors.

In Thailand, Rassameethes (2012) considered the growth of ICT to be normal or average when measured against worldwide indices, lowest in infrastructure and digital content. ICT development does not seem to be a priority for Thai government. Moreover, this study found that consensus on budget, standard and equipment issues has not been reached. Each department has initiated its own ICT-related projects, which sometimes override those of other departments. This lack of cooperation has resulted in overlapping problems, inefficiency, loss of money and unsatisfactory outcomes for all. These issues must be dealt with in order for the ICT masterplan to be successfully
implemented. Another study reached similar conclusion. Techatassanasoontorn, Huang, Trauth and Juntiwasarakij (2011) tracked Thailand’s information economy development and found that progress has been deterred by challenges in unequal development across regions, accompanied by a workforce with limited skills and low R&D expenditure in ICT sectors. They suggested that Thailand’s future growth depends largely on increased investment in technology and innovation.

According to the Global Competitiveness Index, technological readiness can be measured based on an economy’s agility to adopt existing technologies for productivity enhancement, particularly in terms of its capacity to leverage ICT in everyday activities and production processes to enable better efficiency and innovation to improve competitiveness (GCR, 2013–2014). Thailand is ranked 78th in technological readiness index of 148 countries worldwide, and can learn from more successful countries, such as Ireland, China and India. The experiences of these countries suggest that Thailand could benefit from increasing the supply of skilled workers, providing more facilities that enhance its distinctive capacities in the ICTs sector, and reconfiguring and adapting its information policy to synchronise with changes in the global ICT market.

Lastly, in terms of technological readiness, the origin of technology is not as relevant as its ability to enhance productivity. Of central importance is ensuring firms can access, absorb and use these advanced products and blueprints. This is why FDI—the main source of foreign technology—plays a key role for countries with low technological development. As a country less known for technology and innovation, Thailand should not only depend on FDI for its technological development, but also must acquire the ability to use existing technology to enable more efficient production, improve production facilities, and use the experience gained in production and investment to further develop the technology in use.
4.5.1.10 Tenth pillar: Market size. In contrast to the pre-liberalisation period, when markets available to firms were constrained by national borders, today’s trade openness allows international markets to substitute domestic markets in many countries. The vast majority of empirical evidence indicates that trade openness has a positive effect on growth, especially for developing countries with small domestic markets. Moreover, when both domestic markets and international markets are included in determining a country’s market size, exports become important in substituting for low domestic demand. An increase in market size enables exploitation of economies of scale, and enhances the country’s international trade position, thereby raising its overall productivity and international competitiveness. This can be measured by domestic market size index, foreign market size index, GDP and exports as a percentage of GDP.

As presented in much literature on FDI and economic development, the size of the market is viewed as one of the main determinants for productivity growth. In 2014, Thailand was ranked 22nd and 16th in its domestic and foreign market size, respectively, based on WEF data. This reflects its competitiveness with a sizable domestic and foreign market. Further, the export sector—which has previously been an important contributor to Thailand’s GDP—also remains competitive, ranking at 21st with a share of export at 76.1 per cent of GDP. Thailand’s relatively stable overall competitiveness—despite persisting weakness in its institutions, rule of law, infrastructure and quality of education—is attributed to strengths derived from the relatively large size of its domestic, regional and international markets, which enable Thailand to achieve economies of scale through lower costs of production.

Despite internal political problems, Thailand is able to maintain an open market-oriented economy and encourage FDI through participation in regional development. Opportunities have been increased by the creation of the AEC, which enables free flow
of goods and services in a single market for all member countries, and provides member
countries with greater access to the global market. The current aim is to take advantage
of the tremendous opportunity to trade with larger countries, such as China and India,
where the total market size of two billion people promises a huge increase in cross-
border trade, with lower costs. Regional connectivity and subregional cooperation in the
AEC’s 2015 framework serve to realise economic and social change in multiple
dimensions, especially in terms of a growing market size and greater business diversity.
New generation businesspeople who possess higher education and more specialised
knowledge of their industry are emerging as new market challenges for existing players,
thereby increasing the prospect of higher competition and growth. Additionally,
Thailand is strategically advantaged in terms of geography, and should develop goods
and services that meet the new market demand, especially among the large consumer
groups in India and China. This needs to go alongside promoting sustainable investment
and supporting local small and medium enterprises (SMEs) to achieve quality and
sustainable growth.

**4.5.1.11 Eleventh pillar: Business sophistication.** Business sophistication refers
to a country’s overall business networks and quality of firms’ operations, which can be
measured by local suppliers’ quantity and quality, comparative advantage, cluster
development, value chain breadth, international distribution control, production
processes and level of marketing, as well as a country’s willingness to delegate
authorities. The 2013-2014 GCR revealed considerable room for improvement for
business operations in Thailand. Thailand ranked 41st of the 144 countries in the
business sophistication pillar, with developed clusters (40th) and companies operating
across the value chain (38th) requiring improvement among local firms. Recently, the
cluster concept has gained prominence as an economic policy tool that increases
productivity and operational efficiency, stimulates innovation, and facilitates
commercialisation and new business formation. The idea is essentially that, when firms
and related economic institutions are interconnected in a geographically contiguous
setting, they can benefit from their mutual proximity and connection. This creates better
opportunities for firms because barriers to entry are lowered and possible knowledge
spillover is increased, thereby potentially enhancing operations across the country’s
business sectors. Moreover, sustainable linkages between firms, partners and support
institutions can enhance individual firms’ competitiveness, and increase their capacity
to deal with economic crises through collective effort and cooperative strategy. This
also enables more inclusive development because small firms can contribute to
economic activities on fairer terms. In terms of national competitiveness, heightened
geographic concentrations of cluster industries promote better value chain and local
supplier specialisation for both the quantity and quality of products, thereby leading to
higher business sophistication and national competitiveness overall.

Clusters and foreign investments are interdependent phenomena due to the
nature of clusters, which helps foster the rapid diffusion of knowledge and skills, as well
as developing strong linkages and externalities that enhance absorptive capacity.
Considering the externalities created by inwards FDI, the cluster theory proposes a
competitive strategy of maximising the positive externalities created by MNEs and
attracting FDI to specific sectors. Not only does well-planned cluster development help
local firms grow beyond their individual constraints, it also pressures the government to
implement better policies to create a win–win situation for both MNEs and regional
development. Successful clusters also generate employment, income and opportunities
for the local community, and ultimately become key drivers of local economic
development, especially for developing countries. Examples of successful clusters are
evident in the rapid development of Silicon Valley, the Seattle aerospace complex and the New York financial cluster.

Thailand’s cluster development has been reasonably successful in terms of attracting FDI, especially in automotive, hardware and communication or ICT sectors. According to Charoen (2012), the government’s FDI policy has resulted in the investment of many global companies in ICT, which has greatly contributed to the manufacturing industry, especially for hard disk drives, electronics and computer parts. However, despite their benefits, clusters can be shallow if they lack government support or collaboration is weak. This seems likely to be the case in Thailand, where most MNEs invest in production facilities ultimately to export their products, rather than to transfer knowledge and expertise to local firms. Moreover, heavy exploitation of Thailand’s cheap, unskilled labour has activated price-based competition for goods and services. Firms would rather produce in large quantities and sell at lower prices than produce higher-quality products and sell fewer products at higher prices. This is reflected in Thailand’s ‘business sophistication’ pillar of competitiveness, as reported by WEF (2014), where local supplier quantity (23rd) is ranked higher than local supplier quality (42nd). There is no drive for firms to shift from price- to quality-based production because the majority of consumers are from a lower-income group, who have little or no information about products or services, and subsequently make their consumption decisions based mostly on price. As a result, many clustered firms eventually become sluggish or stagnant, and perform below expectations, with their development potential untapped. These firms soon face severe bottlenecks because they operate on outdated technology and lack infrastructure and basic services, which limits their ability to improve productivity and capture new market opportunities. Labour remains cheap but low skilled, while entrepreneurs are dispirited by limited access to
credit and other facilities for business expansion. Existing firms’ efficiency and productivity are low because production remains limited to a narrow range of goods and service, which can only be improved by access to new sources of technology and innovation.

Past studies show clear evidence of significant cluster effort and presence in Thailand; however, researchers have come to realise that their strengths are predominantly in unrelated areas. Even though the Thai government places high importance on cluster development as another driver for export value creation and local employment, the institutional environment is unaccommodating of the needs of firms in the clusters, and fails to provide the required services and assistance. This results in firms being locked into either a stagnant cluster or price competition, and disregards the national environmental and labour standards. The United Nations Industrial Development Organization’s approach to cluster development also recognises certain obstacles for developing economies, such as high transaction costs related to gathering and processing information for industry assessment, costs required for collaboration when institutions are weak, a low level of trust among cluster firms and institutions, and a large imbalance of power and wide technology gap between large-scale MNEs and local SMEs.

A few studies have been conducted to examine Thailand’s clusters. In particular, Charoen (2011) provided some interesting insights in his diamond model analysis of Thailand’s ICT cluster. Charoen found that the lack of clear understanding of cluster policy by the government and lack of suitable institutions to manage it reduce Thailand’s ICT competitiveness. Despite being perfectly located at the heart of Southeast Asia, telecommunications infrastructure remains a major weakness of Thailand; thus, the Thai ICT cluster had not yielded the expected results. The cluster
was found to be quite shallow, with more conflict than collaboration between firms. Inter-organisational competition sometimes overshadows cooperation, as reflected in odd legal disputes between institutions in cluster and government agencies. From a political perspective, the instability of the Thai legal system and government corruption present ongoing obstacles to cluster development and success. Competition in the ICT market is neither fair nor free, as the government interferes by granting monopoly concession, which impedes the normal functioning of the cluster. Every concession agreement has different conditions, which has led to unfair competition (Charoen, 2012). For these reasons, there are persisting weaknesses in Thailand’s ICT cluster, such as poor distribution of internet and fixed-line phones, and limited access for people in rural areas.

Additionally, although the complexity of Thai products has increased drastically during the past 30 years—with electrical, electronic and automotive products comprising approximately 40 per cent of Thailand’s exports—the sophistication of tasks, rather than products, needs to be assessed. The research, design, development and branding of Thailand’s most sophisticated export products are usually completed abroad, while technology is already embedded in new imported machinery and equipment. As a result, the tasks performed in Thailand remain relatively simple, despite the more complex products, which makes it more difficult for Thailand to improve its value chain breadth. This is where innovation is important, as a group of complex tasks involving R&D. Innovation is the key aspect of development that has left Thailand lagging behind.

4.5.1.12 Twelfth pillar: Innovation. Policies that aim to continuously build on existing competitive advantage are no longer wise for Thailand because the nature of its competitiveness is changing. While improving institutions, building infrastructure,
reducing macroeconomic instability and improving human capital remain high on the agenda, they are likely to reach diminishing returns at some point in the future. This concern was earlier raised by Krugman (1994), who stated that the stage of economic development has reached a degree at which pure reliance on comparative cost advantages such as low wages is by no means sufficient to sustain competitiveness and high growth rates. Thus, upgrading technological capabilities and innovative capacity is the key success factor for future economic development for every nation. In particular, as the Thai economy develops, factors that used to be important strengths may not have the same effect in the future. The WEF strongly emphasises reliance on the innovation pillar as the main engine for increasing standards of living in the long term, by accelerating the process of technological catch up, and sustaining productivity growth and competitiveness. Innovation can be thought of as a group of complex tasks that includes research, development and design. It involves creating new products or processes, which depends on a country having high-quality scientific research institutions, government procurement of advanced technological products, university–industry linkages (UILs), spending on R&D, the availability of scientists and engineers and utility patents.

The national innovation system (NIS) approach has gained increasing attention and been adopted by many policymakers in both developed and developing countries, including Thailand. However, while this framework was designed to enhance knowledge sharing and support innovation activities by firms, it has potential problems, including infrastructure, capability, network, institutional, and transition and lock-in problems (Chaminade, 2012). Inadequate infrastructure constrains firms’ abilities to conduct research and innovation. Capability problems limit knowledge transfer and collective learning, while low levels of scientific and technological capability prevent
firms from fully assimilating sporadic knowledge generated by other firms in the system. Further, network problems may cause firms to be reluctant to share knowledge, despite sound network functioning, if the intellectual distance is too great. Most importantly, some firms may find themselves facing system lock-in problems, in which they are simply unable to respond to changes due to limited technological capabilities in a particular technological field. In addition to firm-related issues, insufficient supportive systems may lead to problems arising from a lack of institutions needed for innovation processes related to social standards, regulations and laws, and political background.

All of these problems are possible explanations for Thailand’s lack of innovation. While a review of the literature showed limited research on Thailand’s innovation policy, there has been some interesting work by Intarakumnerd (2002), Schiller (2006), Patarapong and Brimble (2007) and Chaminard (2012) in examining Thailand’s NIS. It was observed that the development level of Thailand’s NIS does not follow its economic structural development level. Unlike developed countries, Thailand’s shift from agriculture to industrialisation was implemented without a strong foundation, and was unaccompanied by sufficient technological progress; thus, its NIS remains noticeably weak and fragmented. This presents a mismatch in the system, and has partially contributed to Thailand’s past economic crises (Intarakumnerd et al., 2002).

Thailand’s weak UILs and lack of cooperative alliance between firms to research particular technology or products prevent the country from progressing, like Japan or Taiwan. Not only do Thai universities have low research capability, but most of their research has little to no relevance to the industry. Further, unlike China, Thailand lacks collective native innovation that contributes to the dynamic technological capabilities of local firms. Therefore, Thailand’s inability to enjoy the
same benefits of FDI inflow as China, in terms of contribution to technological advancement, may be because the R&D activities of MNEs cause negative effects on local firms’ technical change.

Considering this, Doner (2013) offered good insight to the effects of FDI on Thailand’s technological development and innovation. Linking Thailand’s weak UILs to its bureaucratic fragmentation—conditions that constitute the broader political economy of policies and politics—Doner (2013) identified several reasons that Thai firms have been less demanding for technological assistance and innovation support. First, extensive growth generated mostly by MNEs’ exports reduced pressure to improve other development capacities. That is, Thailand’s competitive advantages (in wages, labour and land) increase incomes and production, but do not improve its long-term capacities. Second, Thailand’s trade and investment regime openly favours MNEs over domestic firms. This induces the type of inward FDI that exploits suddenly lower costs in labour and land, rather than FDI related to new technical capacities. This extensification, driven by the government’s short-term foreign exchange needs, turned the government’s focus to developing new technological capacity in MNEs, rather than product engineering in local firms. Third, the government’s concentration on S&T promotion strategy on MNEs’ technology transfer has largely undercut its previous efforts for other technological development goals (process improvement, engineering and design), which are often more feasible for local firms. Finally, Doner (2013) identified weaknesses in Thailand’s FDI policies’ focus, which is primarily on attracting new industry to Thailand, and only tangentially considers improving the technological base of the economy. Most primary MNEs bring their first-, second- and third-tier suppliers to the region, which results in extensification, but not intensification, of the
The study also found that Thailand’s business organisations generally exhibit an insufficient collective focus on technology-driven productivity improvement.

The government needs to re-prioritise its policies concerning FDI, and be mindful that, while increased competitive pressure from MNEs can encourage local firms to be more productive in order to ward off competition, increased competition in local markets may have negative consequences for local firms, especially if they are not adequately supported by the government. In the case of Thailand, the government’s excessive FDI promotion favours MNEs over domestic firms, and fails to gain positive effects from MNEs’ presence in terms of R&D and innovation. This is because too much emphasis has been placed on attracting FDI, without understanding how to optimise its benefits for the economy.

**4.5.1.13 Interrelation of 12 pillars of competitiveness.** These 12 pillars of competitiveness are not independent, but are interrelated; thus, a limitation in one area creates negative effects on others. For example, the innovation pillar (twelfth pillar) cannot be improved if workers lack good health (fourth pillar) and higher education (fifth pillar) that enables them to learn and absorb new technologies (ninth pillar) in firms that have sufficient access to finance (eighth pillar) R&D in order to grow in an efficient goods market with greater potential to become more competitive in the global market (sixth pillar). Although the pillars are aggregated into a single index, the WEF reports these measures separately in order to provide all countries with further detail of which specific areas they need to improve.
4.5.2 SWOT analysis.

**STRENGTHS**
- Large market size
- Advantageous geographic location
- Good logistic system
- Rich natural resources
- Competitive labour cost
- Strong FDI promotion
- Expanding production base
- Improving financial market
- Resilient FDI, exports and tourism

**WEAKNESSES**
- Political instability
- Excessive red tape
- Pervasive corruption
- *Coups d'état*
- Poor IP protection
- Capital congestion and pollution
- Uneven development
- Income inequality
- Inadequate supply of skilled personnel
- Weak technological learning
- Poor English literacy
- Low R&D investment
- Lack of innovation and UILs
- Poor educational system
- Weak links between MNEs and local firms (low technological transfer and spillovers)
- Ineffective industrial clusters policy
- Weak law enforcement
- Unreliable public servants
- Poor policy implementation
- Disjointed governance

**OPPORTUNITIES**
- AEC 2015
- Exploitable proximity of large export markets
- Trade liberalisation
- Financial liberalisation and supportive investment policies
- Robust business sectors
- Large pool of informal workers
- Mismatched employment that causes untapped potential

**THREATS**
- Global economic and financial crises
- More FDI competition
- Increasing evidence of 'brain drain' effects
- Ageing population
- Middle income trap

*Figure 4.14. Thailand’s SWOT analysis.*
4.5.2.1 Strengths. One of Thailand’s important strengths is its large market size, especially in relation to FDI attraction. Since its liberalisation, Thailand has become a key production base for global firms from Japan, the US and Europe. The fDi Markets tracks the location motives for 2,898 FDI projects recorded in 2013 (fDi report, 2015). The percentages in Figure 4.15 below show that Thailand’s FDI is primarily market-seeking, and is driven by domestic markets’ potential (45 per cent) and proximity to regional markets and customers (33 per cent).

<table>
<thead>
<tr>
<th>Motive</th>
<th>Projects</th>
<th>% of projects</th>
</tr>
</thead>
<tbody>
<tr>
<td>Domestic market growth potential</td>
<td>840</td>
<td>45.4%</td>
</tr>
<tr>
<td>Proximity to markets or customers</td>
<td>611</td>
<td>33%</td>
</tr>
<tr>
<td>Regulations/business climate</td>
<td>380</td>
<td>20.6%</td>
</tr>
<tr>
<td>Skilled workforce availability</td>
<td>328</td>
<td>17.7%</td>
</tr>
<tr>
<td>Infrastructure and logistics</td>
<td>158</td>
<td>8.5%</td>
</tr>
<tr>
<td>Industry cluster/critical mass</td>
<td>119</td>
<td>6.4%</td>
</tr>
<tr>
<td>Attractiveness/quality of life</td>
<td>89</td>
<td>4.8%</td>
</tr>
<tr>
<td>IPA or government support</td>
<td>75</td>
<td>4%</td>
</tr>
<tr>
<td>Technology or innovation</td>
<td>57</td>
<td>3.1%</td>
</tr>
<tr>
<td>Lower costs</td>
<td>47</td>
<td>2.5%</td>
</tr>
<tr>
<td>Other motive</td>
<td>194</td>
<td>10.5%</td>
</tr>
</tbody>
</table>

*Figure 4.15. Thailand’s location motives for FDI in 2013. Source: fDi Report (2014).*

Even though Thailand has a generally low score on many pillars of competitiveness, its large and growing market size allows continuous flow of inward FDI to the country, as evident in the past. Moreover, Thailand’s comparative advantage in geographical location enables proximity to markets and customers, which is the second highest motive for FDI—comprising one third of the total world FDI projects (fDi Report, 2014). Otherwise, the country appears to do well in improving its financial markets, as reflected by its reduced inflation, contained public debt, higher market efficiency and savings rate, and almost balanced budget in 2013.
4.5.2.2 Weaknesses. Unquestionably, one of Thailand’s major weaknesses is its fragmented political and institutional systems. These shortcomings are reflected in the Index of Economic Freedom (IEF) score, measured by the Heritage Foundation. According to the IEF, Thailand’s 2014 economic freedom score declined by 7.9 points over 20 years—one of the largest deteriorations since the 1997 AFC (Heritage, 2015). This continuously deteriorating freedom score is mostly due to the perceived level of corruption and a legal system that is susceptible to political influences. Indeed, the most significant long-term change appears to be the deterioration in the country’s rule of law, as measured by property rights (-45.0) and freedom from corruption (-36.4).

Correspondingly, the WEF (2013) also indicated that Thailand’s top four problematic barriers to undertaking business were corruption (20.2 per cent), government instability/coups (16.5 per cent), policy instability (13.5 per cent) and inefficient government bureaucracy (13.4 per cent).

Corruption is said to be the root of Thailand’s political and government instability, affecting business attitudes, investors’ confidence and consumers’ mindsets. Public sector corruption comes in many different forms, as often witnessed in Thailand, such as children being discriminated against and denied an education; vote-buying elections; and bribes and ‘under-the-table’ deals that steal resources from the most helpless and undermine justice, economic development, social morals, ethics and public trust in the authorities. The legal loopholes and lack of political discipline in the government amplify both domestic and cross-border corruption. Compared to the rest of the world, Thailand’s perceived levels of public sector corruption are relatively high, ranked 102nd of 175 countries in the Corruption Perceptions Index (2013).

![Corruption Perceptions Index 2013: Asia Pacific](image)

**Figure 4.17.** Corruption Perceptions Index for the Asia-Pacific region in 2013. Source: Transparency International (2013).

Corruption in Thailand affects all aspects of the economy, and many industries suffer in terms of business operation and investment. Examples can be seen in the tourism industry, where alleged corruption has affected investment and hindered the
speed of economic development. These effects became more pronounced after the 2006 coup, with every successive administration being hindered in their operations, and failing to achieve progress in any aspect of the economy. The political instability continued throughout the decade, with 21 changes in the minister position on average per year from 2002 to 2011. In 2008 alone, there were three different administrations, with the shortest lasting for only 75 days. According to Pitsuwan (2013), the cost of corruption is estimated to be 30 to 35 per cent of any investment in Thailand, costing over 100 billion baht per year. Accordingly, corruption is viewed by foreign investors as the most problematic factor to undertaking business in Thailand. To the rest of the world, Thailand is losing attractiveness due to its political impasse, and it surprises no one that the economy has performed poorly during the past year.

Aside from politics, Thailand also suffers from problems caused by increased human activities and prosperity, amplified by climate change. As well as increasing concerns regarding the living environment, Thailand’s ageing population is also perceived as one of the country’s disadvantages. With the rapid approach of an ageing society, almost one third of households are now headed by an elderly person. It is argued that this rapidly ageing population will create new public health and social challenges. While the elderly are traditionally valued for their experience, wisdom and sensible guidance, they also have increasing dependency on younger generations due to changing economic and social conditions that leave them with lower wealth, poor health, illness and an increasing need for more medical attention and care.

Unsurprisingly, the elderly group is less active in the labour market and engages more in advising, babysitting, housekeeping and counselling. This presents some serious concerns because, as the age structure shifts towards higher age groups, there is a relatively smaller working age group to support the increasing number of elderly
people. From an economic perspective, such changes have negative effects on income per capita, savings and investments, as well as leading to the need for increasing welfare payments, social security and public-funded healthcare system for elderly people. From a social perspective, these changing family structures imply decreasing family support for the elderly group, and question the sustainability of the country’s previous success in poverty reduction.

Understandably, the ageing population and increasing number of elderly people are regarded as unfavourable, especially in terms of the economic and financial growth of developing countries. As a result, many Asian governments encourage family planning programs and related measures to lower fertility. However, compared to other countries, Thailand’s ageing population is growing at an increasing rate following Singapore. This is shown in the following figure.

![Figure 4.18. Percentage of total population aged 65 or over (per cent of total population). Source: Southeast Asian Economic Outlook (2011/12).](image)

Not only does the ageing population pose a medium-term risk in the region, but the demographic changes have important implications for Thai families, especially in
terms of social and health services. That is, compared to the rest of the population, the elderly group have a much higher chance of serious health issues, and thus pressure on health facilities and services will increase enormously. Indeed, the multiple problems of the large semi-permanent population of low-skilled migrant labour and Thailand’s own ageing population suggest rising domestic demand for private healthcare. Problems are further intensified by the presence of the ASEAN community, where Thailand’s combination of an ageing society, medical and retirement tourism promotion, migrant labour, and higher inflow of patients and outflow of personnel under the AEC will amplify the demand for health services and medical personnel.

The other major weaknesses discussed earlier remain, with low investment spending on R&D, the shortage of S&T personnel, weak technology learning and UILs, and fragmented NIS all reducing Thailand’s ability to extricate from the middle-income trap to move towards an innovation-driven stage (WEF, 2013). Without domestic innovation and technological development, Thailand suffers from a significant gap between the advanced nature of its export structure and the much more modest technological levels of its production processes (Doner, 2011). This leads to uneven development, where the country is successful in structural transition, yet fails to achieve upgrades in terms of improving productivity and innovation. In another sense, Thailand is also unbalanced in terms of regional development. To avoid confusing these two problems, regional disparity is referred to here as ‘unbalanced growth’. In addressing this issue, the 2010 UNDP Human Achievement Index (HAI) examined four indices that relate to service delivery: health, education, income, and transportation and communication. It found that Bangkok outperformed other regions in all dimensions, as expected (Figure 4.19). This was mirrored by regional disparities in public expenditure and service delivery, which is discussed in more detail below.
In the development process, the government has two possible strategies:

1. ‘balanced growth’—simultaneous investment in a wide range of industries
2. ‘unbalanced growth’—investment in a few of the most productive industries that take advantage of forward and backward linkages in the production process.

The government usually allocates scarce resources to a few industries and few companies in each industry at a time. Thus, major industries in this stage of development are monopolised by a single firm or handful of firms. One significant side-effect of this unbalanced growth strategy is inequality in income distribution. Indeed, although Thailand’s average incomes and poverty statistics have improved, inequality in income and wealth remain high (HDI, 2014). It appears that promoting non-agricultural manufacturing industries has widened the gap in the population, and income equality in Thailand has been deteriorating since the 1960s. This is a problem that the country is still trying to overcome. Previous studies have argued that capital liberalisation leads to increased wage and income inequality (Das & Mohapatra, 2003; Te Velde & Morreisey,
and there is evidence of corresponding increases of FDI and widening income inequality in Thailand. Te Velde and Morreisey (2002) found supporting evidence of an unfavourable effect of FDI on income distribution in Thailand from 1985 to 1998. This implies that the same impressive growth of export and FDI data that is used to highlight the success of the RTG’s FDI policy equally indicates its failure to reduce income inequality over time.

Since its financial liberalisation, Thailand’s composition of FDI has changed significantly. Due to a relatively limited supply of skilled labour and its poor educational system, Thailand has failed to meet the increasing demand for skilled labour required for FDI. Based on empirical analysis, Velde (2004) tested the effects of FDI on wages and wage inequality in five East Asian countries from 1985 to 1998, and found that FDI has indeed widened the wage gap in Thailand. This study aptly summarised the fact that the education system in Thailand, which has not been designed to maximise the benefits of FDI, needs investment in good quality teaching to improve human quality. This is especially important for countries pursuing development based on FDI; otherwise, they may face the possibility of growth coinciding with rising wage inequality, as Thailand has experienced.

This highlights one of Thailand’s major weaknesses—education, which ranks poorly against other ASEAN countries, at eight out of 10, which is lower than Vietnam and Cambodia (WEF, 2013). Although Thailand’s enrolment ratios and mean years of schooling have increased, there is reasonable concern over remaining inequality in access and the substandard quality of education at all levels. According to Thailand’s Human Development Report (2014), the quality of education has fallen, with students performing inadequately in international tests, such as the Programme for International
Student Assessment (PISA).\textsuperscript{11} In addition, students’ lack of English skills is critical, especially in the light of the upcoming ASEAN integration (or AEC). Moreover, children from the lower household income quintile have six times less chance of entering higher education, and are subsequently deprived of opportunities to maximise their potential and contribute to society, as well as missing the chance to improve their own living standards. Over the past decade, the government has allegedly spent the largest portion of its budget on education; however, their investment is not generating expected returns, as displayed in the following figures illustrating the government’s expenditure and Thai students’ scores on PISA tests.

\begin{figure}[h]
\centering
\includegraphics[width=\textwidth]{figure42.png}
\caption{Thailand’s selected ministries’ budget in 2000, 2011 and 2013 (billions of baht). Source: Bureau of Budget (2014).}
\end{figure}

\textsuperscript{11}The PISA is a part of the OECD in Paris, which was established in 1998 and organises international examinations for participating countries every three years.
These graphs show that the largest budget share (20 per cent of the overall national budget—or four per cent of GDP) has been spent on Thai education, yet this has resulted in lower than the expected outcome. Students’ abilities in mathematics and reading have hardly improved, and their ability in science has declined over time. Thailand’s PISA scores\textsuperscript{12} during the past nine years have shown no discernible progress whatsoever. This calls into question the quality of the Thai educational system and raises the possibility of misspent budget in the educational sector. Further, the government’s effort in education development has not extended throughout the country, with many Thai children still unable to read and write. The PISA score draws attention to the disparity between socioeconomically disadvantaged students from poorer rural areas and privileged students from wealthier urban areas. The average reading score is only 373 for the first group, compared to 542 of the latter group. According to the OECD, these scores indicate more than four school years of difference, making

\textsuperscript{12} PISA scores are on a scale. The majority of students in participating countries score between 400 and 600. The top 25 per cent score between 500 and 550, while the lowest 25 per cent score less than 400.
education outcomes and urban–rural disparities the top two challenges in human capital development for Thailand. On the international scale, the percentage of Thailand’s national budget devoted to education is consistently higher than in other ASEAN countries, yet Thailand still lags behind most Asian countries and performs well below the OECD average in both mathematics and science (see Figure 4.22).

*Figure 4.22. PISA scores in mathematics and science in Thailand and other selected economies. Source: OECD (2011).*
These scores place Thailand in the last quartile or bottom 25 per cent, ranking 50th of 65 countries in 2009. General concerns for the Thai educational system have drawn researchers’ attention to the ‘educational paradox’—a concept that is used to explain that merely increasing financial resources cannot raise standards of education (OECD, 2013). Thailand’s educational paradox is illustrated by Figure 4.23, which indicates that the country’s public expenditure on education is higher than the OECD average, yet its PISA score is below the OECD average.

![Figure 4.23. Efficiency of the education sector in Thailand and other selected economies in 2009. Sources: OECD (2011).](image)

Thai policymakers must take these results seriously, as they indicate an inherent weakness that threatens the country’s overall development and future prospects. While it has been recognised that education is the foundation of Thailand’s endeavour to achieve a knowledge-based society and shift away from its low-wage, low-cost model of development, the country’s inward-looking curriculum that emphasises rote learning
and downplays critical thinking does not prepare students for such progression. This weakness is more pronounced in the light of rising global competition, particularly among ASEAN countries for international investments following the commencement of AEC in 2015. While countries such as Vietnam become increasingly attractive to international investors due to their low labour cost, large market size (over 92 million in population) and impressive PISA scores (placed 17th of 65 countries in 2013), Thailand’s fading attractiveness is highlighted by its low PISA scores, with less improvement than countries such as Mexico, Turkey, Brazil and Indonesia.

From all the weaknesses identified above, weak governance stands out as one of Thailand’s biggest areas of concern that is central to all other problems. Political instability, excessive red tape, pervasive corruption, misspent budgets, security concerns and high uncertainty regarding property rights protection have all badly undermined Thailand’s institutional framework, and rendered other development plans unattainable. According to the GCR (2014), Thailand ranks below 100 for most of these areas—for example, the level of trust in politicians ranks very low at 129. Meanwhile, the Institute for Management Development (IMD) survey also determined Thailand’s challenges to be mainly related to politics and governance, and recommended reform in these areas in order to rebalance the economy. Suggestions included strengthening the corruption regulator network, strengthening public participation in all areas, improving healthcare and education, and reforming the social system. Taken together, it is concluded that the country’s main weaknesses are largely related to the poor performance of the government. Thailand’s past competitive advantage, which has long been considered its main strength, has solely been based on low labour cost; however, because this is becoming unsustainable, the country must upgrade to a ‘knowledge economy’. This
development paradigm focuses on other areas in which business can improve regardless of the political environment, such as R&D, innovation and entrepreneurship.

4.5.2.3 Opportunities. Ideally, problems arising from systemic deficiencies also imply vast growth opportunities for developing countries in education, healthcare, environmental improvement, provision of infrastructure and political stipulation. Improvements in these fundamental areas can help a country overcome major gridlocks and bottlenecks that hinder capital mobility and human development. With Thailand’s geographic proximity among ASEAN countries and close ethnic ties with China, it has great potential to become an investment base to serve as the gateway to ASEAN and the world market for Chinese firms (Li, 2014). For example, under the China–AFTA, Thailand is in a good position to play a significant role in manufacturing and exporting Chinese products to the ASEAN region.

Changes are expected to occur after the launch of the regional integration of AEC, bringing both opportunities and challenges to ASEAN countries. Changes in the international economic platform have shifted greater economic power to Asia, while changes in competition and the business model have created a single market base that allows freer flow of resources and investments, thereby increasing Thailand’s opportunities to expand its regional supply chains. In Thailand, both the government and business sectors have responded with enthusiasm, while others have presented more anxiety. For example, the general public are somewhat apprehensive about these changes because many feel threatened by increasing job competition for workers and intensifying resource competition among producers. Critics argue that ordinary people will have even less influence over policy making, and that the privileged will benefit, while the less fortunate majority will be disadvantaged.
4.5.2.4 Threats. The most immediate risks to Thailand’s future growth are the pace of recovery of the global economy and Thailand’s political situation. For most developing countries, including Thailand, economic performance significantly depends on the economic performance of advanced economies. Problems among major trading partners, such as the US and Japan, can interrupt Thailand’s export growth and discourage MNEs from investing in FDI projects. In addition, a tepid recovery in the global market and slowing in the Chinese economy will have a negative effect on Thai exports. Apart from external threats, such as global crises and natural disasters, Thailand also faces major challenges from increasing global competition and the pressure of being stuck in a ‘middle-income trap’. This is a situation in which Thailand is threatened by lower-wage rivals, such as Vietnam, but lacks the technological capacity to compete with higher-wage, higher-productivity rivals, such as Taiwan (Doner, 2011).

Thailand’s increased political risk casts a shadow over its business environment and doubt over the stability of its policies relating to infrastructure investments. In addition, it raises questions about the validity of excessive military spending that diverts financial resources away from other development priorities. The political gridlock has already led to deteriorating confidence in state governance, and created difficulties related to routine tasks such as passport issuance, investment approvals and other administrative processes. Delays in long-awaited major public infrastructure projects—such as water management and logistic improvements—will affect growth in the long term. Continued political instability also distracts governments from fixing long-term development issues, such as improving human capacity and national competitiveness.

Another potential threat comes from leading businesses’ large vested interests in service sectors, such as tourism, real estate, entertainment, property and
telecommunication. These industries tend to benefit more from government protections—such as licensing, incentives and concession arrangements—than do other businesses that are more exposed to global competition, such as the manufacturing industry. As a result, the sector that stands to benefit most from the government’s development programs may have the least influence over policy development.

4.6 SWOT Summary

Overall, a country’s national competitiveness is considered the most important indicator of the country’s ability to improve its position in the global market. Prior to FDI decisions, investors routinely consider the host country’s sectoral performance, contributions to GDP, market size, FDI inflows, openness, financial access, corruption index, export performance and other macroeconomic indicators. In terms of politics, Thailand’s competitiveness has unquestionably been undermined by pervasive corruption and incessant political warfare. In terms of economics, Thailand has been unable to grow in a well-balanced manner since the 1997 AFC. Critics believe that Thailand’s overreliance on exports to restore growth makes the country highly vulnerable to global downturns.

In times of recovery, the RTG often resorts to fiscal stimulus and monetary easing measures, which are short term in nature, which raises questions about their sustainability and suitability as a rebalancing strategy. It is argued that, in the long term, Thailand needs to depend less on exports and tourism, and more on other domestic sources of growth, such as workers’ skills, education and technological progress. There have already been a number of discussions on these issues, especially among dependency theorists, about rebalancing growth to be more dependent on domestic demand and less on exports. However, no actions have been taken to realise these goals because no proper analyses have been conducted on this issue, and thus no clear policies
can be effectively implemented. Although the RTG has initiated small projects—such as the Small Village Fund, potential development of villages and communities program, and various other projects—these projects only aim to stimulate consumption, not investment. As a result, the RTG is unable to achieve sustainable development, and unfair income distribution remains an obstacle to real poverty alleviation.

Finally, in terms of FDI, despite growing pressure to attract higher value-added and technology-driven FDI, Thailand has certain constraints in its institutions that hinder the speed and implementation of change. First, Thailand’s FDI policies have been passive and concentrated only on increasing production and export growth, and have subsequently failed to enhance industrial competitiveness. Second, Thailand has a general tendency to evaluate FDI based on its quantity, rather than the quality of its effect on the economy. Considering these problems, the government needs to reconsider its FDI policies in order to focus more on areas beyond the basic incentive promotion that they have employed in the past.

4.7 National Policy Recommendations

Past studies have shown that forces of economic and geographical integration have profoundly affected the areas in which firms invest, and what technologies Thailand should adopt. From the above analysis, Thailand’s below-expectation economic growth in the recent years appears to be largely due to lack of innovation, productivity growth, technological progress and education development. In terms of sustaining the country’s competitiveness against rising competition, Thailand urgently needs to improve its technology infrastructure by increasing its budget on investing and upgrading ICT and R&D. Past research has shown that Thailand’s public and private sectors both fail to emphasise the role of developing advanced and specialised factors sufficiently, as do Singapore, Malaysia and Vietnam.
A general recommendation is to create a better learning and knowledge system that involves specialised higher education institutes and dedicated R&D institutes, supports domestic talents and entrepreneurship, entails better intra-cluster transportation and ICT, and has a closer connection to the outside world. Note that only this general recommendation is provided at this point. More thorough discussion of the directions and suggestions for future government policy for Thailand are discussed in the final chapter, after presenting solid empirical evidence in order to avoid the inevitable subjectivity that may arise when country comparisons are made.

4.8 Proposed Research Contribution to the Literature

Ultimately, this study sought to determine the true relationship between FDI and economic growth for Thailand. Quantitative analysis was required to identify the existing causal link and evaluate FDI contribution in different sectors of the economy, which might have important implications for development strategies for Thailand. Chapter 5 continues with a more critical analysis of FDI in Thailand based on Thailand’s history and investment development path (IDP), with particular focus on the RTG’s FDI policies. Chapter 5 discusses Thailand’s performance in terms of the contribution of FDI to GDP and employment growth. This is done specifically to explore different areas or sectors for potential FDI inflows that will be more appropriate to Thailand’s stage of development and available human capital in terms of skills and knowledge. Finally, this chapter presents a review of relevant empirical studies of FDI in Thailand in order to verify the related theories and policies.
Chapter 5: Thailand’s FDI Liberalisation and the Effects on Thailand’s Sectoral Development

5.1 Introduction

Thailand’s trade and investment liberalisation took a significant turn in the early 1990s when the Thai government was pressured by both internal (growing domestic manufacturing) and external factors (the World Trade Organization and Asia-Pacific Economic Cooperation) to reduce the tariff rates on many products. Theoretically, trade liberalisation is expected to provide many benefits, such as improving allocative efficiency, and enabling higher productivity, higher accessibility of foreign exchange and lower prices. However, empirically, these benefits and their role in successful industrialisation remain questionable.

This chapter continues the discussion of FDI in Thailand in a more comprehensive manner, based on a historical review of Thailand’s trade liberalisation. It begins with an overview of Thailand’s economic development from its early liberalisation in the 1950s to the present. This chapter aims to provide insight to Thailand’s unique experiences with liberalisation, and its FDI performance over the years of changing trade regimes. In particular, it focuses on the effects of the major crises encountered by Thailand over the years—the 1997 AFC and 2008 GFC. It aims to determine the driving forces of FDI inflow to Thailand, and the FDI strategy employed as the economy struggled through a series of global economic fluctuations. These past experiences should help determine existing threats to and opportunities for future growth as the country faces intensifying competition from other ASEAN member countries.

As a contribution to the limited empirical studies in this area, the remainder of the chapter is dedicated to a sectoral analysis of FDI in Thailand. Following a study by
Puapan (2014), a similar methodology is adopted to reassess the effect of inward FDI on Thai economic development in selected sectors, with updated data. The results should support the hypothesis that FDI has a positive effect on the host country’s economic growth, with a few exceptions for sectors that have specific preconditions or barriers. The value of this research lies in identifying which sectors are most conducive to FDI, and which major barriers to FDI exist for less successful sectors. Ultimately, it aims to identify which sectors have the potential to perform more successfully in the future given greater FDI inflow.

5.2 Historical Development

5.2.1 Import Substitution (IS) regime: 1958–1971. Prior to the IS regime, Thailand was largely governed by state monopolisation in most industries, particularly in the imports and exports of primary products, such as rice. The economy was driven by agriculture under state supervision, while domestic private investment and production in manufacturing was limited by the lack of education, technology, capital investment and entrepreneurship among locals. This period of state capitalism lasted until the late 1950s, when the role of state enterprises was greatly reduced as the country underwent a shift in national trade regime and became more engaged in international trade through economic diversification policies, such as industrial development and enhanced agricultural production. The IS strategy was introduced as the country launched its first national economic development plan to promote industrialisation. The policy was aimed at fostering private enterprises, while committing to foreign trade, exchange liberalisation and nominal control of foreign exchange.

Specifically, the IS policy advocates that a country can reduce its foreign dependency through developing domestic industries. Thus, it embraces strong protectionist policies of high trade barriers, nationalisation, subsidisation of key
industries and discouragement of FDI. This inward-looking theory has commonly been practised by developing nations to increase domestic activities and reduce mass poverty during their first stages of development. Likewise, Thailand’s IS policy aimed to promote self-sufficient internal market development by replacing foreign imports with domestic production. The key strategy was imposing tariffs on imports, particularly on finished products. High priority was given to building the institutional system for industrial development, while the role of the RTG and its involvement in the economy was narrowed to key utility and infrastructure sectors to support private enterprises. During this period, FDI in Thailand was predominant in textiles, automobiles and chemicals. However, the IS policy, which took full effect in the 1970s and unofficially lasted well into the 1980s, was focused more on imposing tariffs, rather than attracting FDI.

Although IS policy is a development theory, its political implementation and theoretical rationale are derived from international trade theory, and often connected to ‘dependency theory’, which is traditionally adopted by a much broader Marxist framework. Dependency theory was developed in the late 1950s by Raul Prebisch, based on neo-Marxist views that persistent poverty is a consequence of capitalist exploitation (Noonan, 2010). Prebisch offered a straightforward explanation for the phenomenon that poor countries’ growth relies on primary commodity exports to wealthier countries, where these commodities are manufactured and sold back to poorer countries in the form of final products. Since the value added to consumer products always costs more than the input, poorer countries are exploited by wealthier countries because their import payments usually exceed their export earnings. The IS policy was proposed for developing economies to reduce their dependency on advanced economies by substituting foreign manufactured products with local ones. Figure 5.1 illustrates
Thailand’s trade performance during the IS regime. The country somewhat managed to control its level of imports, while exports remained limited because they were not promoted during this time. The overall trade performance was mediocre at this stage of development.

**Figure 5.1.** Thailand’s import and export of goods and services as a percentage of GDP (1960–1971). Source: WDI (2013).

While this type of conservative policy seems practical for a country’s early stage of development, there may be some challenges in actual implementation. First, if the internal market is too small, domestic firms will not have the same benefits of economies of scale and low production costs as do foreign firms. Thus, fear of foreign domination has become a prominent concern regarding liberalisation. Second, in terms of preferred domestic production, institutions can play an influential role. If this is the case, the policy direction and outcome may depend more on political motivations, rather than economic motivations. Finally, the effectiveness of the policy depends on national
food security and how much control the country has over its own primary products for export.

For Thailand, while this policy may have helped promote growth in manufacturing investment, it also triggered income inequality between agriculture and non-agriculture sectors (Inthisang, 2008). Subsequently, Thailand’s IS policy only lasted until the early 1970s, when the country experienced severe BOP problems due to a loss of foreign spending after the US withdrew its military troops from Vietnam and the substantial reduction of export revenue from the main agricultural products. In 1974, the tariff structure deepened, especially for final products, and remained so until the late 1980s. The distortions caused by preferred final goods production, and common signs of structural indebtedness from IS-related policies led to international organisations (such as the IMF and World Bank) insisting on structural adjustment programs for liberalisation, and a shift towards an Export Promotion regime.

5.2.2 Export Promotion (EP) regime: 1972–1992. Although the RTG announced the restructuring of Thailand’s development strategy from an IS to EP regime in the early 1970s, the shift in regime was gradual and only became noticeable in the mid-1980s. Traces of the IS policy remained evident until 1985, when FDI inflow was first diverted to export-oriented activities in light manufacturing industries, such as clothing, textiles, footwear and toys (Kohpaiboon, 2003). Later, FDI also shifted to labour-intensive activities in electronics and electrical goods. Concurrently, a more substantial reduction of tariffs was applied in 1988 for electrical and electronic goods and their inputs. By the end of the 1990s, the maximum tariff rate was reduced from 100 per cent to only 30 per cent, thereby allowing Thailand to successfully shift its trade and industrial policy from a highly protectionist regime to an export-oriented one. This period also witnessed a major structural change in production. The agricultural sector,
which expanded rapidly during the 1960s and 1970s, was now faced with two major obstacles to advancing growth: (i) declining trends in world prices since 1980 and (ii) rapidly dwindling forest areas suitable for agricultural production. The average agricultural growth from 1974 to 1985 was a mere 3.8 per cent, compared to 6.0 per cent from 1960 to 1973. Meanwhile, the country’s industrial policy transformation from IS to EP gained momentum.

![Agriculture, value added (% of GDP)](chart)

*Figure 5.2. Thailand’s agriculture as a percentage of GDP (1961–1985). Source: WDI (2013).*

The shift in the composition of FDI from domestic market–oriented to export-oriented production closely mirrored the shift in the domestic trade policy regime, as highlighted by the *Investment Promotion Act 1977*\(^\text{13}\). The RTG strongly promoted FDI and MNEs as the key to the knowledge, skills and training needed to develop an industry and strengthen its comparative advantages. Under the *Investment Promotion Act*, the BOI was established to design Thailand’s investment promotion under lawful conditions.

\(^{13}\) Thailand’s Investment Promotion Policies have recently been altered in order to “Open a New Door to Foreign Investors”. According to ASEAN Briefing (2015), the BOI announced significant changes under the new Investment Promotion Act (B.E. 2520), where foreign investors in Thailand are granted higher financial incentives and privileges. These include added tax reduction and exemptions, and special permits for foreigners to enter, study, work, and transfer money abroad. These changes are expected to have direct effects on foreign direct investors, but the results are yet to be determined.
discretion. For example, fiscal and non-fiscal incentives—including tax holidays and discounted import duties on machinery and raw materials—were granted to approved applicants. Inclusively, both domestic and foreign investments were encouraged to direct their production towards accommodating external demand. However, it was found that MNEs tended to benefit more than domestic firms from investment incentives schemes because the RTG increased tax incentives to help reduce business tax burden and facilitate the entry of MNEs. Likewise, Thailand’s BOI granted special privileges to foreign investors to induce them to invest in particular projects or activities.\(^{14}\) In this view, past government policies seemed more focused on increasing locational advantages so that MNEs were able to internalise their transactions and gain more from the market than domestic companies. Accordingly, Thailand’s currency under the fixed exchange rate system was devalued several times to allow local export-oriented industries to maintain price competitiveness, and reduce imports of inputs. However, the unfavourable world economy in the early 1980s led to mounting pressure on the Thai currency, and tightening of fiscal policy in 1982, which resulted in a deceleration of exports, growth and development.

The success of EP policy relies on the free play of market forces, neutrality of policy, and unbiased competition between foreign and local firms. This allows the host country to fully exploit the benefits of FDI by providing an ideal climate for MNEs, and encouraging efficient allocation of all resources to stimulate further investment in technology and human capital. The EP policy in Thailand achieved significant export growth towards the end of the 1980s. Figure 5.3 indicates the shift in export composition, where manufacturing grew in response to industrialisation, and agriculture

\(^{14}\) For details, see Rochananonda (2006).
declined. This reflects Krugman’s (1991) view on international trade theory and uneven economic development, with state increasing returns only found in the manufacturing (urban) sector, and diminishing returns only found in the agricultural (rural) sector.

![Agriculture v. manufacturing exports (1970–1986)](chart.png)

*Figure 5.3.* Thailand’s export growth in annual percentage (1970–1986). Source: WDI (2013).

In particular, substantial growth in non-traditional sectors, such as manufacturing and machinery production, was achieved by increased protection of the industrial sector and extensive promotion for high capital investment. However, for high-quality assurance purposes, export-oriented FDI in manufacturing typically requires high-tech products from foreign companies—either purchased from subsidiaries in the host country or imported from abroad. As a result, Thailand had very little development of forward linkages and relatively low levels of value-chain multipliers and spillover effects into the rest of the economy (Mirza et al., 2004).

Moreover, after the oil crisis during the 1970s, the RTG encountered serious budget deficit problems that had been accumulating since 1976. During these difficult times,
instead of stimulating the economy, the EP policy actually increased pressure on the government to provide large-scale infrastructure for manufacturing production, under the constraint of decreasing tax revenue. In these circumstances, EP policy can actually worsen the fiscal position. The infrastructure constraint and increasing unit cost of production forced Thai policymakers to accept that the EP policy had reached a bottleneck, and they subsequently revised their FDI incentive policy in the early 1990s. Adoption of more neutralised incentive policies and changes in the world economic environment at the time allowed for an improvement in technologies, which decreased transportation, communication and other trade costs. Further, gradual tariff reform and revised foreign business ownership regulation significantly increased FDI inflow to Thailand.

The growth of exports generally resulted in better use of idle resources, and enabled a substantial increase in investment. However, while these export expansions and large capital inflows enhanced domestic economic growth, the success of the Thai economy during the late 1980s and early 1990s was unequally distributed to members of society. As a result of resource reallocation in response to changes in trade composition, some sectors expanded, while others contracted. Table 5.1 shows that growth in the primary sector fell behind the secondary and tertiary sectors during the EP regime. For example, agriculture grew by only 77.5 per cent from 1980 to 1990, while electricity, gas and water supply grew by a massive 518.36 per cent in the same period. High growth was also evident for manufacturing, construction and other services, while slow growth was experienced by sectors related to crops, livestock and fisheries, and negative growth was experienced for forestry towards the end of the decade.
### GDP by Industrial Origin and National Income (in Millions of Baht)

<table>
<thead>
<tr>
<th>Year</th>
<th>Agriculture</th>
<th>Crops</th>
<th>Livestock</th>
<th>Fisheries</th>
<th>Forestry</th>
<th>Agricultural</th>
<th>Simple</th>
<th>Mining and quarrying</th>
<th>Manufacturing</th>
<th>Construction</th>
<th>Electricity, gas and water supply</th>
</tr>
</thead>
<tbody>
<tr>
<td>1980</td>
<td>153,401</td>
<td>100,486</td>
<td>17,025</td>
<td>8,342</td>
<td>8,495</td>
<td>13,362</td>
<td>7,631</td>
<td>113,565</td>
<td>28,403</td>
<td>7,709</td>
<td></td>
</tr>
<tr>
<td>1981</td>
<td>161,851</td>
<td>104,024</td>
<td>17,413</td>
<td>10,712</td>
<td>9,439</td>
<td>13,362</td>
<td>7,949</td>
<td>137,637</td>
<td>33,517</td>
<td>11,121</td>
<td></td>
</tr>
<tr>
<td>1982</td>
<td>155,449</td>
<td>98,452</td>
<td>15,224</td>
<td>10,936</td>
<td>8,533</td>
<td>15,034</td>
<td>10,686</td>
<td>142,394</td>
<td>38,471</td>
<td>15,827</td>
<td></td>
</tr>
<tr>
<td>1983</td>
<td>184,100</td>
<td>119,379</td>
<td>20,120</td>
<td>12,400</td>
<td>9,052</td>
<td>15,366</td>
<td>11,867</td>
<td>162,380</td>
<td>44,951</td>
<td>17,112</td>
<td></td>
</tr>
<tr>
<td>1984</td>
<td>173,000</td>
<td>110,152</td>
<td>17,641</td>
<td>11,852</td>
<td>9,399</td>
<td>15,883</td>
<td>16,037</td>
<td>181,604</td>
<td>51,549</td>
<td>18,564</td>
<td></td>
</tr>
<tr>
<td>1985</td>
<td>166,380</td>
<td>103,235</td>
<td>15,866</td>
<td>13,108</td>
<td>9,216</td>
<td>16,292</td>
<td>22,263</td>
<td>190,696</td>
<td>52,964</td>
<td>24,896</td>
<td></td>
</tr>
<tr>
<td>1986</td>
<td>176,809</td>
<td>103,917</td>
<td>20,682</td>
<td>15,626</td>
<td>9,655</td>
<td>18,270</td>
<td>17,717</td>
<td>216,736</td>
<td>54,755</td>
<td>28,821</td>
<td></td>
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<tr>
<td>1987</td>
<td>203,709</td>
<td>120,372</td>
<td>23,628</td>
<td>20,102</td>
<td>10,721</td>
<td>20,062</td>
<td>20,029</td>
<td>258,426</td>
<td>60,777</td>
<td>33,213</td>
<td></td>
</tr>
<tr>
<td>1988</td>
<td>251,591</td>
<td>157,372</td>
<td>25,922</td>
<td>25,233</td>
<td>10,266</td>
<td>22,963</td>
<td>24,022</td>
<td>308,447</td>
<td>71,149</td>
<td>35,229</td>
<td></td>
</tr>
<tr>
<td>1989</td>
<td>279,094</td>
<td>174,809</td>
<td>29,797</td>
<td>27,449</td>
<td>8,181</td>
<td>28,180</td>
<td>28,977</td>
<td>392,349</td>
<td>97,980</td>
<td>42,392</td>
<td></td>
</tr>
<tr>
<td>1990</td>
<td>272,284</td>
<td>157,482</td>
<td>32,764</td>
<td>32,208</td>
<td>7,281</td>
<td>31,756</td>
<td>31,824</td>
<td>469,511</td>
<td>130,707</td>
<td>47,669</td>
<td></td>
</tr>
</tbody>
</table>

Source: NESDB (2013).
5.2.3 Industrial decentralisation: 1993–1996. Under its trade and investment liberalisation plan, Thailand joined the Asia-Pacific Economic Cooperation forum and World Trade Organization to pursue a higher degree of economic integration and trade liberalisation. The country undertook free trade initiatives as a key international trade strategy, beginning in 1993. Since then, a number of FTAs have been implemented between Thailand and other countries—namely, ASEAN in 1993; with India in 2004; with Australia in 2005; with New Zealand in 2005; ASEAN-China in 2005, 2007 and 2010; with Japan in 2007; ASEAN-Japan in 2009; ASEAN-Korea in 2009 and 2010; ASEAN-India in 2010; ASEAN-AU-NZ in 2010; and with Peru in 2011.

Awaiting initiatives are Chile, Hong Kong, the European Union, Turkey, Pakistan and Canada (Department of Trade Negotiation, 2015). Significant changes in trade policy—such as Thailand’s 95 per cent tariff reduction of Thai goods under the FTA with Japan—has created a wider market opening for Thailand’s trade in goods, and forged a closer relationship with Japan—the largest investor in Thailand for many years.

In the financial sector, restrictions on currency convertibility were also lifted at the beginning of the 1990s. As the capital account was opened up to short-term money movements, capital inflows became abundant, especially in the forms of bank loans and portfolio investment. This caused rapid growth in the domestic real estate sector. Thus, from 1992 to 1995, the main destination of FDI shifted to the service sector, especially in real estate and finance.
The policy rearrangements also enhanced Thailand’s role as an industrial exporter, instead of a primary producer. Thus, growth in traditional export sectors—such as agriculture, food processing and textiles—decelerated, thereby transferring a pool of cheap and unskilled labour to manufacturing. As expected, exports of technology-based industries products grew in response to the above policies. Indeed, the share of manufacturing in exports increased six-fold during the second half of the 1980s, and the share of exports to GDP doubled from 20 to 40 per cent from 1985 to 1995. This indicates that Thailand’s developmental path became more dependent on exports and inward FDI from this period onwards.

5.2.4 Liberalisation (post-AFC): 1997–2004. Prior to the AFC in 1997, Thailand’s rapid economic growth was largely driven by growing FDI inflows and exports. The key challenge for Thai-based producers by the mid-1990s was to enhance production capabilities and move up the value-added ladder in response to intensifying competition from lower-wage countries, such as China, India, Indonesia and Indochina. However, in accelerating the process of liberalisation, a large influx of foreign funds was carelessly poured into unproductive or less competitive businesses and non-trade sectors, such as real estate, which created a financial bubble in Thailand. The country’s financial liberalisation through cheap and easy funds inversely downgraded its competitiveness once faced with high demand for inputs, higher production costs and a
sharp decline in export earnings. At the same time, short-term debts and the non-performing loans of financial institutions were mounting up, leading to an accumulated deficit in Thailand’s current account balance.

An unstoppable disaster occurred as the BOT failed to defend the Thai baht from financial speculators, and lost a huge amount of international reserves. On 2 July 1997, the Thai government floated its currency, triggering a collapse of the financial sector and a devastating economic crisis. Within a few months, the value of the Thai baht floated from 25 baht per US dollar to the lowest point of 56 baht per US dollar. The immediate effects of this crisis were transmitted to neighbouring Asian countries, such as Indonesia, South Korea, Hong Kong, Laos PDR, Malaysia and the Philippines, resulting in widespread decline in GDPs, increasing inflation and deterioration of other growth variables for the region. Ultimately, inadequate financial sector supervision resulted in mismanaged policies that distorted Thailand’s lending relationship. Large quantities of credit increased the asset prices to an unsustainable level, and debt obligations were defaulted. This caused lenders to panic and withdraw their credits, inevitably leading Thailand to bankruptcies.

In terms of FDI, the sharpest reversal in net inflow was experienced by Thailand, with recorded negative inflows for four consecutive years from 1997, and a total net outflow of capital amounting to US$45 billion—or almost half the net inflows during the seven boom years from 1990 to 1996 (Athukorala, 2003). Industrial investments essentially crashed as over ₱400 billion worth of approved investment was either cancelled or delayed without notice. Domestic demand also suffered while manufacturers struggled with overcapacity across several industries. Specifically, there were contractions of 80 per cent in auto parts, 50 per cent in construction materials and
40 per cent in electrical appliances. During this time, Japan remained Thailand’s largest source of FDI, mostly in automobiles and parts.

This financial crisis—caused by a combination of inadequate financial regulation, weak governance, deteriorating industrial competitiveness and export performance—forced the Thai government to shift its focus to restructuring its financial system. In the context of finance and real sector reforms, the role of FDI in Thailand became more critical than ever. The government extensively promoted FDI to recapitalise falling industries, create new technology and generate new jobs. Thus, during the first two years of the post-crisis era, the economy registered negative expansions in line with contractions of growth engines; however, recovery occurred during the subsequent years after necessary restructuring and reforming that was reflected in most major GDP components. Soon after, inward FDI returned to the industrial sector, particularly in manufacturing. However, this new era of FDI was predominantly led by merger and acquisitions as a result of the post-crisis devaluation of the Thai baht and the fire-sale of assets due to business insolvency. Thus, the anticipated productive capability development from this post-crisis FDI may not be as growth-enhancing as is often portrayed in the government’s and banks’ reports.

In terms of policy development, the contrast in Thailand’s foreign policy orientation became more pronounced in the period surrounding the crisis. For more than half a century, the government played an active role in conducting investment and international trade. During the pre-crisis period, the government was responsible for establishing relevant policies regarding investment promotions and restrictions. However, post-crisis, Thailand engaged in a higher degree of liberalisation, as recommended by the IMF. Specifically, both current and capital accounts became more liberalised via bilateral and multilateral agreements for Thailand’s reform. Various
legislations were enacted to encourage foreign participation in the hope of speeding up economic recovery after the 1997 crisis. In particular, the *Condominium Act 1998* was revised to give foreigners full ownership of buildings on a maximum of two acres of land, while the *Foreign Business Act 1999* allowed full foreign participation in key manufacturing industries, and the *Bankruptcy Act 1940* was amended in 1999 to protect foreign investors through establishing a central bankruptcy court. During this period, the ASEAN Investment Agreement was implemented. Other liberalisation acts included permitting full ownership of shares in promoted manufacturing projects in 2000, and lifting local content requirements for vehicle assembly in 1999 and for dairy products in 2003.

While capital account liberalisation can have many positive implications for financial markets and can improve resource allocation, it also entails certain risks if not accompanied by the necessary structural reforms and sound macroeconomic policies. Without prearranged protective measures and structural adjustments, capital account liberalisation can increase pressures on existing domestic financial institutions and highlight their internal weaknesses. In effect, Thailand faced a banking crisis as a result of large capital inflows, followed by a sharp reversal in capital flows. Considering this, serious attention needs to be paid to sequencing capital account liberalisation with structural measures, especially in the monetary and financial sectors, and to pace liberalisation in conjunction with the development of appropriate macroeconomic policies. It is suggested that, prior to the financial reforms, the government should have compensation plans for all affected parties, including workers who are threatened with unemployment and decreasing wages, and SMEs that are threatened with bankruptcy as interest rates soar. Unfortunately, in Thailand, there is no formal representative of these groups involved in the discussion circles. These problems are critical for Thailand,
where strengthening financial institutions and developing indirect monetary instruments lagged the actual liberalisation of the capital account. In this view, this study suspects that Thailand prematurely embraced a policy that actively promotes capital inflow. The analogy used by Stiglitz (2000) clarified what occurred in Thailand. He compared capital account liberalisation to installing a race car engine in an old car, and beginning to drive without properly checking the tyre conditions and driver’s skills. He postulated that:

Perhaps with appropriate tires and training, the car might perform better; but without such equipment and training, it is almost inevitable that an accident will occur. One might actually have done far better with the older, more reliable engine: performance would have been slower, but there would have been less potential for an accident. Similarly, the international economic architecture must be designed to ‘work’ not just in the presence of perfect economic management, but with the kind of fallible governments and public officials that in fact occur in democratic societies. (Stiglitz, 2000, p. 1075)

In support of this argument, Santipitaksakul et al. (2010) compared Thailand’s distribution of projects granted investment incentives based on ownership during the IS and EP regimes in 1960 to 1974, and the more recent years of 2007 to 2008. They found that the number of 100 per cent owned foreign firms significantly increased from three to 36 per cent, surpassing 100 per cent owned local firms and joint ventures. On the basis of ownership, these distributions suggest that, while the tax incentive scheme was initially enjoyed more by domestic firms, the pattern is now reversed. Thus, they argued that, while Thailand’s FDI policy appears to help enhance locational-specific advantages for the country, it does so at the cost of foreign dominance, with less government assistance given to domestic firms to develop ownership-specific
advantages. To be fair, the government’s actions may be justified to the extent that Thailand lacks the necessary capital to grow on its own; thus, the government needs to provide greater incentives to attract foreign firms that are capable of conducting large investment projects. These so-called ‘mega projects’ are concentrated in technology-intensive industries for alternative energy; environmentally-friendly material production; and high-tech businesses services, including tourism, real estate and high-tech agricultural businesses. However, one aspect that policymakers should consider is that excessive tax privileges can unnecessarily waste national resources; thus, an alternative measure to attract FDI may be to improve the country’s infrastructure and other underdeveloped areas, as will be discussed in the next chapter.

While Thailand has succeeded in attracting substantial inflows of FDI over the past 40 years, a key concern is the long-term effect of these investments on the country’s growth and development. As observed in Figure 5.4, Thailand’s FDI inflows and GDP growth have not necessarily trended in the same direction. Thus, an important question to consider is how much positive spillover will be generated by these FDIs. In previous research, apart from re-examining approaches to growth and development to determine what went wrong in the late 1990s, the issue of FDI and its spillover effects has become a critical area of policy focus throughout Southeast Asia following the 1997 crisis. Thailand was most severely affected by the 1997 AFC, and steadfastly relied on FDI for its post-crisis economic recovery. For this reason, many studies have attempted to examine the behaviour of post-crisis FDI, and the effectiveness of policy responses.
Figure 5.4. FDI and GDP growth (1975–2011). Source: WDI (2013).

Jitsuchon (2002) provided 50 years of detailed accounts of the Thai economy from 1950 to 2000, particularly detailing changes in policies and environments in Thailand in relation to its growth process. The study found that the combination of imbalanced macroeconomic management; inadequate technological advancements; weak financial institutions; and (to a lesser degree) inefficient political, economic and social systems caused Thailand’s crisis in 1997. In terms of the crisis aftermath, Athukorala (2003) found that, while there was a massive capital flight of portfolio investment and worsening short-term debt, FDI was maintained in most East Asian countries. Athukorala argued that FDI is a relatively stable source of foreign capital, and that the presence of MNEs played an important role in accelerating the country’s recovery process.

Pananond (2007) also investigated changes in the dynamic of Thai MNEs after the AFC by analysing FDI statistics and in-depth case studies. The paper found a shift in the dynamic of Thai MNEs’ international expansion, where pre-crisis expansion relied more on networking capabilities than on industry-specific technological skills, and post-crisis adjustments emphasised strengthening their industry-specific
technological capabilities. Investigating the slow post-crisis investment recovery, Wattanakul (2010) found that the AFC had a statistically significant, massive negative effect. Daly and Tosompark (2011) revisited the effect of the AFC in relation to post-crisis determinants of FDI in Thailand, and found that Thailand’s growing market size and increasing average real wage had positive effects on FDI inflow. While the relationship between trade variables and FDI inflow appeared less significant, FDI continued to have a positive relationship with exports. The stronger exchange rate did appear to be negatively related with FDI, but was not highly significant. In regard to the cost of capital, the increasing local spread suggested an increasing perceived risk; however, the variable’s influence on decisions to invest in Thailand required further studies.

5.2.5 Liberalisation (post-GFC): 2008 to present. After recovering from the AFC of 1997 to 1998, Thailand’s growth averaged at around five per cent for 2002 to 2007, yet slowed again in 2009 due to global economic conditions—namely, the 2008 GFC—and political uncertainty in Thailand. In the immediate aftermath of the Wall Street panic in September to October 2008, Thailand—among other EMEs, such as India and the Philippines—responded to massive capital outflows from their markets by tightening monetary policy. This worsened domestic credit conditions and the balance sheets of domestic corporations and SMEs, leading to further dampening of investment demand.

FDI in the past was known to be more resilient to business and credit cycles prior to the GFC. The projected slowing in FDI adversely affected industrial production and other economic activities, as many EMEs had managed to attract a significant portion of inward investment in the recent past. A conspicuous feature of the ongoing financial crisis is that large MNEs in developed countries, which have been one of the
key driving forces behind the current wave of corporate-led globalisation, have been severely affected in their financial capability for further investment and expansion. Both internal and external financial sources have become increasingly limited due to a decline in corporate profits, as well as the reduced availability and higher cost of finance at the time of the severe credit crunches (UNCTAD, 2009).

As the GFC deepened, MNEs began to adjust their investments and undertake significant cuts in their operations, involving closure of production sites across the globe. High-profile mergers and acquisitions were aborted or postponed. A wide range of industries were affected, including mining, automobiles, aircraft and steel—to name a few—in various locations in developed and developing countries. In low-income developing countries, the effects of reduced capital flows due to the GFC have been much less pronounced so far. However, even the prospective effects of reduced private capital flows to low-income countries may not be negligible if a hypothetical counterfactual scenario is taken into account. In this context, the African Development Bank (2008) argued that, as the world economy slows, investment flows that have supported growth in the region in recent years will decline. The effects of the financial crisis on low-income countries will arise through other channels, such as the slowing in world demand for their exports, lower commodity prices, reduced remittances, decline in tourism and reduced or unpredictable aid inflows. Further, a significant number of low- and middle-income countries are predicted to suffer from a reduction in receipts from tourism—another vital source of their service income.

This paper has examined the extent and scale of collateral damage caused by the GFC on the developing world thus far, and discussed the much larger damage inflicted by the globally synchronised slowdown and recession. A United Nations (2008) report suggested that the magnitude of the 2008 crisis reflected an underestimation of the
underlying triggers and undue faith in the self-regulatory power of liberalised financial markets. During each crisis in recent decades, many experts have voiced deep concerns regarding the risk of unregulated market activities in the financial sector, where adequate regulation and supervision are absent. The recent GFC accentuated the extent of widespread market failures in financial transactions. However, expert advice is conveniently overlooked as soon as the global financial system recovers from crises. Their warnings are ignored by politicians and policymakers, who state that the causes of the crises are the inadequate and immature financial systems in developing countries, rather than market failures that may arise in any financial system. In this sense, the GFC is the outcome of governance and market failure (Nissanke, 2010).

Critics argue that globalisation has progressed without adequate governance structures because policymakers place too much trust in the ability of markets to allocate resources efficiently. The ongoing financial crisis exhibits major weaknesses in the international monetary and financial system as a financial intermediation for productive investment and economic development under the current regime. The system has failed to help developing countries industrialise and diversify their economies as part of the structural transformation needed to build a solid foundation for development and poverty reduction. In this sense, the recent financial crises are attributed to weak governance and poor policy management as much as market failure. This calls for more serious efforts from policymakers and politicians to make globalisation successful for all countries. They need to offer more genuine and inclusively beneficial policy, instead of the previous lukewarm policies that do not address the real underlying causes of the crises.

Given Thailand’s changing internal and external economic environment and the rise of the AEC, it is instructive to reassess the effect of the most recent GFC and
confirm the key determinants of Thailand’s FDI inflow. Although relatively newer than the 1997 crisis, the effect of the 2008 financial crisis on the economy has also been evaluated in many published studies. In line with literature on the determinants of growth, Lalaudes (2010) found that the effect of the GFC was more distinct in EMEs, including Thailand. Likewise, Ostry (2011) suggested that high capital inflows embodied in financial liberalisation rendered EMEs vulnerable to large contraction during the GFC. Brockmeijer (2012) collectively reviewed related strands of literature on GFCs and found mixed conclusions on financial globalisation and growth in EMEs, but a strong association between high capital inflows and the likelihood of debt, banking and currency crises in these countries. In Thailand, there is a shortage of data that could be used to monitor the complete effects of the GFC; however, general economic indicators provided by the WDI show that the Thai economy was severely affected by the crisis. Figures 5.5 and 5.6 both show a sharp drop in Thailand’s GDP growth and FDI inflow during the GFC, trended in the same direction as the US and world average. This effect can be partly explained by Thailand’s financial openness to bank-intermediated flows and dependent export links to the US.
Additionally, Thailand’s reliance on exports and FDI growth left the country exposed to the sharp fall in global demand, combined with the domestic political uproar, which damaged consumers’ and investors’ confidence during the same period. Figures 5.7 and 5.8 present the reduced exports and tourism that resulted from this.
These trends raise some concerns that Thailand has not managed to decouple from the global economy, particularly the US. Thus, the future growth and development of Thailand appear to be vulnerable to external imbalances, and closely tied to its major trading partners. Chairathivat (2010) confirmed that the GFC renewed the debate about Thailand’s export dependence, and the instability related to this. He argued that, if
Thailand recovers from the crisis-affected markets, this supports the validity of the export growth model. He suggested that Thailand may achieve more potential future growth from emerging markets such as China, India and other ASEAN countries that have a sizable market to cater for Thailand’s exports. Against this backdrop, the current study argues that, because Thailand has become even more export dependent since the recovery of the 1997 AFC, it should shift its focus from major Western countries to domestic and regional demand, which would lessen its dependency problem.

Haughton and Khandker (2014) examined the consequential effects of the 2008 to 2009 GFC on different sociodemographic groups in Thailand, and found that the most negatively affected group were wage earners in Bangkok due to the sharp drop in export-oriented manufacturing. However, the negative effect of the GFC was not as severe as the 1997 AFC because the BOT was better prepared and ensured that there was sufficient liquidity for its domestic financial institutions. For example, Thailand’s open market operations and end-of-day standing facility were carefully monitored, and short-term money market rates were effectively controlled to align with the policy rate. As a result, the Thai currency was relatively stable compared to other regional currencies because capital outflows were moderated, and Thailand managed to quickly recover from the GFC effects.

In terms of post-GFC FDI, Thailand attracted 17 per cent of all FDI flowing to Southeast Asia during 2004 to 2009; however, the ratio dropped sharply to six per cent during 2010 to 2011. In contrast, Indonesia saw its ratio rise from 13 to 21 per cent in the same period. The rising threat for Thailand is that other ASEAN countries have begun to increase in competitiveness, thereby causing Thailand to lose its attractiveness in the eyes of foreign investors. Deboonme (2012) predicted that Thai companies will soon come under pressure from demographic changes—namely, the shrinking domestic
market, higher foreign competition and domestic labour shortages accompanied by higher wages. The indication of a shrinking domestic market is that elderly Thai (aged 60 and above) now comprise around 11 per cent of the population. Moreover, the birth rate is predicted to decline from 2015 onwards. By general estimation, the working age population will fall, causing labour shortages and reducing consumption. According to the market size hypothesis, markets with a large population and/or rapid economic growth tend to give MNEs more opportunities to generate greater sales and profits, and are thus more attractive to their investments. Meanwhile, several other ASEAN countries’ domestic markets are larger than Thailand’s, which is attributable to their larger populations. For example, Indonesia and the Philippines have children accounting for 26 and 33 per cent of their populations, respectively, and are subsequently guaranteed a huge labour supply and increasing market size, which is attractive to foreign investors.

In addition, the recent minimum wage increase in Thailand adds to the operating costs of Thai businesses, thereby reducing profit and production. However, the minimum wage increase is not without its supporters, who argue that this may improve FDI because higher wages indicate industrial progress from unskilled to skilled labour, or an upgrade of human resources (Jayanthakumaran et al., 2013). Both sides of the argument are possible, and can only be more accurately predicted once the key determinants of FDI inflow are identified by the latest available data. The result from this study’s empirical investigation is expected to provide the RTG with appropriate policy recommendations. Ultimately, the aim of this study is to assist the RTG to create future investment policies for sustainable development and growth, thereby helping secure Thailand’s position in an increasingly competitive ASEAN community.
5.2.6 Current developments. While Thailand managed to survive the GFC, devastating floods in 2011 caused another setback to the economy as a result of severe damage to Thailand’s manufacturing sector. The benefits of Thailand’s economic success have not been shared equally. While poverty has been reduced from its peak of 42.6 per cent in 2000 (a result of the 1997 crisis) to around 13.2 per cent in 2011, income inequalities and lack of opportunities have been persistent—particularly in the north and northeast, which have fallen behind other regions in terms of poverty reduction. The Gini coefficient—a measurement of income inequality in Thailand—has stood at around 40 to 45 for the last two decades.

![Thailand's Gini index (1981-2010)](image)

*Figure 5.9. Thailand’s Gini index. Source: WDI (2014).*

Thailand has followed a dual strategy of promoting exports based on natural resources and exports based on abundant low-cost labour. Both sectors have been important to the export growth and economic prosperity of the country. However, experience illustrates the potential limitations of relying on cost-based international competitiveness, as rising labour and raw materials costs have reduced the
Political economy of FDI in Thailand

Competitiveness of low-end exports. At the same time, 25 years of export growth has stimulated less movement into higher-end products in either sector than was anticipated. Basing industry competitiveness on low labour costs is incompatible with the objectives of improving standards of living over time. Thus, for Thailand to sustain its growth and avoid the middle-income trap, it needs to pay attention to increasing the productivity of not just the manufacturing sector, but also the agriculture and services sectors. Higher levels of education and skills, as well as increased creativity, innovation and competition are necessary. These not only promote higher growth, but also enable inclusive growth that reaches less developed areas and helps reduce the persistent income inequality in Thailand.

On a global scale, the current phase of the world economy is marked by intensifying processes of globalisation. Threatened by potential and actual competitors—such as China, India and Vietnam—Thailand is seeking to lower its cost of production, increase exports and attract further FDI. A number of bilateral and multilateral FTAs have been signed in response to this increased competition, including the AFTA, Japan–Thailand Economic Partnership Agreement, Thai–Peru Free Trade Agreement, Thailand–Australia Free Trade Agreement, Thailand–India Free Trade Agreement and European Free Trade Association. Presently, most of the attention of the RTG in foreign investment is focused on the AEC. Following the pattern of the European Union, the AEC is designed to create a single market and production base. The RTG has magnified the benefits the country can expect to obtain from the AEC due to the country being a regional production and distribution hub. As a result, Thailand’s recent investment policies have focused on liberalisation and encouraging free trade. The RTG is actively promoting foreign investments in favour of those that contribute to developing skills, technology and innovation. Incentives to foreign investors are offered
through supportive services such as the One-Stop Service Center for Visas and Work Permits, import duty exemptions and various reductions to an extensive list of promoted activities (BOI, 2012).

Until the 1997 to 1998 financial crisis, the increasing attractiveness of Thailand’s economy generated benefits from FDI inflows. While its sources of comparative advantage were changing, financial deregulation lured Thailand into abandoning the checks that are essential to a functioning financial system. This instigated the financial crisis, which had dire effects for the country, particularly for FDI outflows. Consequently, the traditional pattern of the IDP was disrupted, and Thailand must realign with a traditional pattern of IDP by pursuing appropriate policies, both at national and sectoral levels.

As the focus on developing competitiveness in Thailand shifts increasingly from macroeconomic to microeconomic factors, and Thailand is forced to move up the value-added chain, a critical challenge will be to develop innovative capacity to advance and commercialise new technologies, products and processes. One of the weaknesses in Thailand’s ability to advance and enhance its comparative advantages may be due to its relatively slow technological development compared to other countries. Innovation can drive the rate of long-term productivity, and hence future competitiveness (GCR 1999), and Thailand has fallen far short in this critical determinant of competitiveness. While overall productivity growth has been moderate, most has been in agriculture or arisen from inter-industry shifts. There has been little indication of growth in technological capabilities. Other barriers to Thailand’s growth in competitiveness have been very low levels and quality of education, serious deficiencies in infrastructure development, and a policy regime at the microeconomic level that was too focused on creating and preserving rents than fostering market competition.
According to the UNESCAP’s 2013 report, the strong Thai baht is becoming a concern because it has demonstrated constrained export performance caused by weak export orders. There has been noticeable decline in shipments of electronics and electrical products, and a slight fall in agricultural products, such as rice exports. However, in contrast, there has been marked improvement in the stock market performance as the appreciation of the Thai currency resulted from increased capital inflows into short-term securities. After the Japanese yen’s depreciation at the beginning of 2013, Thailand was expected to benefit more from cheaper capital imports, thus FDI inflows increased and remained largely stable afterwards (UNESCAP, 2013). A recent study by Anantarangsi (2011) identified various other factors that have reduced Thailand’s attractiveness, including the apparently chronic political instability following the military coup of 2006 and violent crackdown on pro-democracy demonstrators in 2010, and the catastrophic flooding of 2011. Enjoji (2011) reported that flooding and its management, with the possibility of further climate-induced disasters, have seriously eroded investor confidence. In addition, the risk of further flooding is not completely eliminated, and many people remain cautious of future investments.

Thailand has reached a critical crossroads in its quest to regain investors’ confidence and rebuild the competitiveness of its industrial base. Thailand’s weaknesses have been exposed since the AFC dealt a heavy blow to the Thai development model, revealing Thailand’s deficiencies in R&D, S&T and the overall education system. The investments in human resources and R&D that are required to build the foundations for innovation involve a significant public good element, are relatively indivisible and require a long time for the results to become evident. This provides clear economic reasoning for the RTG to seriously commit to supporting programs that will develop a higher-quality S&T workforce, and R&D in both public and private sectors. With
increased recognition that macroeconomic liberalisation and an economy driven by manufactured exports will not ensure sustainable growth, government agents and firms are belatedly shifting their attention to technology matters and human resource development, and hopefully to focus on ways in which FDI can be leveraged more strongly to support these objectives. A high priority must be revising the government’s policy, given that postponing critical commitment to R&D and advancing human development could lead Thailand to a repeated crisis after a minor recovery, or, as stated in a common Thai saying, ‘One step forward, and three steps back’.

5.2.7 Summary and conclusion. While this paper has already examined the effects of MNEs and FDI inflow on Thailand’s early development, ongoing research on Thailand’s FDI is still required to offer fresh insight that reflects the constant evolution of the Thai economy under globalisation, especially regarding the lessons learnt from recent global economic crises. Given Thailand’s current investment attractions—especially its large market size, low labour cost and post-AFC investment policies—the RTG already seems successful in encouraging FDI inflow. However, it may be instructive to redirect attention to the actual benefits gained from these capital inflows, which may be crucial to the country’s long-term growth and sustainable development.

Although not thoroughly explored here, this study recognises that an emerging discussion on qualitative versus quantitative FDI has important implications, especially for developing countries such as Thailand. Due to disparities in the initial endowments of human capital between Thailand and its major trading partners—such as the US, Japan, Singapore and China—this study suspects that Thailand may be constrained from undertaking investments in R&D to generate new knowledge and encourage spillover. Moreover, the benefits that Thailand can gain from FDI require a conductive economic climate. If such a climate is absent, FDI will likely amplify private returns to investment
of MNEs, while producing negligible social returns, which causes FDI to be
counterproductive to internal growth. Therefore, proposed areas for further study
include the effects of FDI on economic development, particularly in terms of TFP,
creating linkages and internalising positive spillovers from MNE activities in different
sectors of the economy. Meanwhile, in addition to improving the key determinants of
FDI, it is also advisable for the RTG to strengthen the country’s local absorptive
capacity by supporting national R&D, technological innovation, higher education and
overall human resource development.

In addition, this study recognises that researching FDI under a different trade
regime is one-dimensional and cannot be used to fully evaluate the effectiveness of the
Thai government’s FDI policy for growth and sustainable development. Hence, it may
be instructive to conduct further analysis with a multi-approach from other related
disciplines, such as international business, legal studies and political economy. Further,
sectoral investigation could be incorporated to determine the most appropriate direction
for future FDI policy to enhance high-potential sectors and ultimately raise the
economy’s standard to be closer to other advanced economies.

Lastly, this study concludes that FDI is a growth-stimulator, yet its benefits are
not automatically generated by free trade policy or complete liberalisation. As Thailand
faces overreliance on continued foreign capital inflows, as well as the loss of authority
and confidence in Thailand’s democracy, resulting from the increasingly noxious and
dysfunctional nature of its domestic politics, greater attention should be paid to building
national strengths—namely, infrastructure, market growth potential and political
stability. This will enhance the presence of FDI by dealing with three related problems
instantaneously—augmenting absorptive capacity, strengthening the country’s
attractiveness on the international scale, and fostering domestic sectors.
5.3 Sectoral Analysis

5.3.1 Introduction. According to the UNCTAD’s 2001 *World Investment Report*, there are limits to the scope for linkages between MNEs and local suppliers in the primary sector, and the scope for dividing and subcontracting production stages to independent local firms in the tertiary sector. Therefore, while FDI conveys benefits to the host country, it is likely that these gains differ across the primary, manufacturing and services sectors. However, past empirical work on the effects of FDI on host countries rarely control for the sectors in which FDI is active due to data limitations and the macro nature of the studies. Indeed, amidst the countless literature on FDI, one area that appears understudied is the sectoral analysis of FDI and its effects on growth.

Sectoral analysis of FDI is important for determining which sectors have a comparative advantage in moving Thailand towards having an advanced economy. This analysis is particularly useful for developing countries competing for FDI inflow, yet there are only a handful of sectoral FDI studies for the case of Thailand (Alfaro, 2003; Puapan, 2014; Wang, 2009). Despite several benefits of using macroeconomic time-series data in previous research, there are some limitations in terms of the relevance of the research question accounting for the whole economy. Although this deficiency has been recognised and a review undertaken of previous empirical works that assessed FDI in Thailand using industrial level data (Santipitaksakul, 2010), a more thorough study at the sectoral level would make an important contribution to the literature.

5.3.2 Sectoral overview. FDI in Thailand reflects changes in the country’s international trade regime. Initially concentrated in an IS industry—especially in textiles and automobiles—until the beginning of the 1970s, Thailand gradually became export-oriented in the mid-1970s. As the country became more liberalised, the abundance of labour and favourable investment promotions offered by the Thai government attracted
more foreign investors to the electronics, electrical goods and automobile industries.

Today, Japanese and US investors are the main investor group with established automotive plants in Thailand. The sectors attracting the highest FDI inflows in 2014 were manufacturing (30 per cent of total), finance (20 per cent) and real estate (10 per cent) (see Figure 5.10). The largest export in 2014 was motor cars, and top export destination was ASEAN (Department of Trade Negotiations, 2015). In terms of employment, Thailand remains an agriculture-based economy, which, in 2014, had the largest contribution to total employment (12,732,720 people), followed by manufacturing (6,393.46 people) and wholesales (6,184.87 people) (NSO, 2015) (see Figure 5.11).

![Sector's share of FDI in 2014 (measured in millions of $US)](image)

*Figure 5.10. FDI classified by business sector of Thai enterprises (US$). Source: BOT (2015).*
Many factors have affected the growth rate in each sector aside from labour and productivity. In recent years, the non-agricultural sector experienced declining growth rates due to a slowing of the manufacturing industry when the government’s economic...
stimulus programs came to an end (such as the ‘first car tax rebate scheme’).\textsuperscript{15} Thailand’s total GDP growth decelerated from 7.3 per cent in 2012 to 2.8 per cent in 2013 as a result of a fall in both internal and external demand, and the unstable political state at the time. Moreover, the export-oriented manufacturing industries benefited less than expected from the global economic recovery because the global demand remained subdued. As a result, not only manufacturing, but almost all sectors showed a decelerating growth rate, including construction, mining and quarrying, and wholesale and retail trade. Exports and imports of goods and services decelerated by 2.8 and 1.4 per cent, respectively (NESDB, 2015).

During this time of economic slowdown, one particular area of interest was the tourism industry, which increased significantly in Thailand, led by the hotel and restaurant sector’s strong growth following the 2008 GFC. This is one of the sectors that brought substantial foreign income into Thailand, accounting for as much as 13.7 per cent of total exports in 2012 (WDI, 2014). Importantly, tourism encompasses a broad range of activities and has been reported to generate a significant amount of employment, with over 2.5 million workers employed in hotels and restaurants, accounting for seven per cent of Thailand’s total labour force in 2014 (BOT, 2015). These benefits have portrayed tourism as one of the main drivers of economic growth in Thailand. During past decades, discussion among Thai policymakers has focused on how tourism stimulates economic activities. However, without any support from empirical evidence, the effect of FDI on tourism and its contribution to output growth remains questionable. Therefore, in addition to the major sectors, such as agriculture and manufacturing, the results from this study’s sectoral analysis will provide an

\textsuperscript{15} These tax breaks, which cost Thailand over US$2 billion, were intended to revive its automobile manufacturing industry in response to the damage caused by the 2011 floods. The scheme ended in 2012, and Japanese automobile manufacturers (who dominated over 80 per cent of the local market) reported a 30 per cent drop in sales, on average, in the second quarter of 2013 (WIR, 2014).
interesting insight to the tourism sector—represented as hotels and restaurants—which will enable a better policy direction for future FDI.

5.3.3 Individual sectors.

5.3.3.1 Agriculture. The agriculture sector is the mainstay in most developing economies to ensure food security, export earnings and rural development. However, there are major constraints that can slow growth in agricultural production, such as lack of skills and standards, inadequate education, labour exploitation, low wages, hazardous working conditions, unstable agricultural product prices and low bargaining power. Past economic data show evidence of declining trends for agricultural production in Thailand compared to manufacturing and services, as illustrated in Figure 5.12.

![Value added by sectors (1960-2013)](image)

*Figure 5.12. Thailand’s value added by sector (1960–2013). Source: World Development Indicators (2014).*

Based on the value added as a percentage of GDP, the agricultural sector has the lowest growth rate among the three sectors of agriculture, industry and services, and appears more vulnerable to international changes. Not only has the agricultural sector been subjected to constant government intervention in terms of pricing systems, export
taxes, quotas and different regulations, but the sector also has high FDI restriction,\textsuperscript{16} both in comparison to other sectors and other Asian countries. Restrictions of foreign investment can take many forms and vary by country and sector; however, the most common restrictions on FDI are generally limits regarding foreign ownership.

Table 5.3

*Restrictions on FDI Policy by Sector*

<table>
<thead>
<tr>
<th>Sector</th>
<th>Indonesia</th>
<th>Malaysia</th>
<th>Philippines</th>
<th>Singapore</th>
<th>Thailand</th>
<th>Vietnam</th>
</tr>
</thead>
<tbody>
<tr>
<td>Overall</td>
<td>27.3</td>
<td>41.0</td>
<td>21.9</td>
<td>12.5</td>
<td>25.2</td>
<td>31.5</td>
</tr>
<tr>
<td>Agriculture</td>
<td>25.7</td>
<td>26.0</td>
<td>37.5</td>
<td>2.5</td>
<td>32.0</td>
<td>19.0</td>
</tr>
<tr>
<td>Manufacturing</td>
<td>44.8</td>
<td>23.2</td>
<td>13.5</td>
<td>5.0</td>
<td>14.3</td>
<td>7.0</td>
</tr>
<tr>
<td>Electricity</td>
<td>20.5</td>
<td>52.5</td>
<td>19.5</td>
<td>100.0</td>
<td>28.0</td>
<td>37.5</td>
</tr>
<tr>
<td>Hotels and restaurants</td>
<td>12.5</td>
<td>74.2</td>
<td>9.5</td>
<td>2.5</td>
<td>28.0</td>
<td>8.5</td>
</tr>
<tr>
<td>Finance</td>
<td>19.3</td>
<td>44.5</td>
<td>14.5</td>
<td>10.0</td>
<td>33.0</td>
<td>16.0</td>
</tr>
</tbody>
</table>

Source: Corbett (2009).

A sectoral comparison revealed that Thailand’s restrictions on agriculture FDI policy (32.0) are higher than those of Indonesia (25.7), Malaysia (26.0), Singapore (2.5) and Vietnam (19.0). It is interesting to note that a successful country such as Singapore has allowed FDI in most sectors, while protecting only the electricity sector, whereas Thailand has placed restriction on all sectors, with the highest protection on agriculture and finance, and the lowest protection on manufacturing sector.

A study by Supannachart (2010) investigated Thailand’s FDI inflow in the food-processing industries and agricultural sector from 1970 to 2009, and found that the FDI inflow gap has increased over time, as shown in Figure 5.13.

\textsuperscript{16} A study by Urata and Ando (2010) evaluated the FDI policies of 10 ASEAN countries by measuring the restrictiveness of FDI using a firm-level survey based on six aspects of the policy regime: market access, national treatment, screening and approval, board of directors composition, movement of investors, and performance requirement.
Figure 5.13. Thailand’s FDI inflows to the agricultural and food-processing sectors (measured in millions of US dollars). Source: BOT.

Figure 5.13 shows that the food-processing industry has done well in attracting FDI, while the agricultural sector has an alarmingly low FDI, which is concerning because the latter is critical for the former as a part of the value chain of manufacturing inputs. Ideally, the two sectors should prosper together; however, this is not the case in Thailand. Although Thailand has long played a role of a major food exporter with high potential in the global market, the government has attempted to protect the agricultural sector by regulating imports and employing a number of complex trade instruments, including tariffs, quotas, surcharges and licensing for various agriculture products, such as rice, sugar, wheat, beans and coconuts. In terms of investment, despite offering a few income tax exemptions, the government does not permit MNEs to operate in the majority of agricultural activities. Specifically, enforcement of the Foreign Business Act 1999 restricts foreign investors’ participation in primary agricultural production, such as rice farming, forestry and fishery. These measures aim to raise domestic revenue and keep domestic agricultural prices and labour costs low. Moreover, restrictions such as

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17 See the Department of Foreign Trade’s Ministry of Commerce for details.
the rule of land ownership prevent foreigners from owning land, while the fixed export
tax, *ad valorem* duty, volume limits and content requirements are placed on primary
agricultural exports, such as rice. These government restrictions are justified by the need
to raise resources to invest in other sectors of the economy, while protecting national
food security and domestic employment in the agricultural sector. As a result, investors
have typically operated in the form of joint ventures, which are limited to export-
oriented activities in certain food-processing and agro-industries. Most of these
investors are from the Asian region, particularly Japan.

To an extent, Thailand’s high border protections have suppressed growth in its
agricultural sector, which has left it lagging behind other sectors, and have further
deprived citizens due to restricting the country’s development and growth opportunities
that could have been extended through higher FDI. In addition, based on assessing
ASEAN’s FDI climate, Urata and Ando (2009, 2010) identified problems faced by
major Japanese firms related to institutional problems (such as a lack of transparency in
investment policies and regulations) and implementation problems (such as complicated
procedures related to investment regulations). Although neither institutional nor
implementation problems are necessarily discriminatory against MNEs, foreign
investment activity could be better promoted if these problems were eliminated. Thus,
undue government policies may have been the main reason for Thailand’s deteriorating
agrarian conditions. However, despite the declining shares of agricultural GDP, the
agricultural sector remains an important source of raw materials for rural income,
agribusiness and export earnings that contributes fairly to overall economic
development. The resource requirements for infrastructure, manufacturing and other
expanding sectors are drawn from agriculture over time, and the majority of the indigent
population in rural areas still relies on agriculture production. Importantly, during the
recent financial crisis, this sector was able to absorb a substantial amount of displaced workers and help relieve much of the associated social cost.

Thailand’s agricultural sector encompasses many stakeholders who are impoverished and have poor bargaining power, such as small farmers. Therefore, governments need to assist in trade negotiations that can broaden the international market for Thai agricultural products, and allow proper and fairer distribution of benefits to all domestic sectors involved. Presently, Thailand’s agriculture sector faces many challenges as it seeks to develop further. Aside from the recent debate surrounding the government’s agriculture policies—particularly the controversial rice support policies—raising the sector’s productivity and managing the declining labour market are also proving difficult. Many farmers face problems regarding the availability of seed, fertiliser, irrigation, labour and cultivation. Moreover, they lack financing and marketing power, and are often faced with low prices for their products, resulting from market distortions, which are insufficient to cover their production costs. In addition to these pressing issues of increasing land cultivation, irrigation and investment in human capital, future growth in agriculture also depends on further investment in agricultural R&D, machinery and other agricultural capital. As this sector is constrained by a lack of funds, it is necessary to consider lowering the government’s restrictions and allowing further FDI into the sector.

Thailand is an agricultural-based country with almost 40 per cent of the labour force engaged in this sector (BOT, 2015). Agricultural workers are also the lowest paid of any major economic activity in Thailand. However, very few foreign investors are interested in this sector, judging by the small number of applications for promotional privileges to the BOI. In 2013, only 1.3 per cent of the total FDI was directed to the agricultural sector (BOT, 2014). Boonlua (2011) gave two possible reasons for this.
First, agricultural-based industrial production appears less attractive to foreign investors due to the unreliable price of agricultural products in the global market, and the considerable risk involved because of unpredictable and uncontrollable factors, such as weather and changing climates and trading regimes. This aligns with a recent report by NESDB (2015), which stated that there are present risk factors and limitations for the agricultural sector because world agricultural prices show no clear sign of recovery.

Second, the lack of foreign investment could be due to the Thai government’s policy for controlling price and quantity in the country’s major agricultural products, such as rice and sugar, in which investors require government authorisation before exporting to other countries, which are strictly under the government list. As a result, there are very few successes in agriculture that are not involved with or subsidised by the government.

Additionally, the World Bank (2014) reported that Thailand’s agro-exports have been contracting in recent years due to a decrease in rice exports, rubber prices and shrimp production. All these situations create an unattractive setting for foreign investors.

In terms of the political economy, agriculture is a highly protected industry by the Thai government.\(^{18}\) After the economy shifted from IS to EP, with a rapid increase in the manufacturing sector, there was even less evidence of the role and pattern of FDI in the agricultural sector. Although FTAs were introduced to widen market access and expand trade opportunities for agriculture, the benefits received were partial. According to the Office of Agricultural Economics (2009), households’ agricultural income increased only slightly from US$3,821 in 2007 to US$4,406 in 2009. Instead, foreign firms and investors received the most benefits, while Thai farmers remained poor due to

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\(^{18}\) The criteria of foreign shareholding for activities in agriculture and agricultural products are stated under List One of the *Foreign Business Act 1999*, which indicates that most primary agriculture—such as rice farming, animal farming, forestry, fishery in specific economic zones, and extraction of Thai herbs—are prohibited to foreign operations. Restrictions are lifted for specific BOI-promoted projects (in agriculture, fisheries and so forth); however, shares must be held by Thai nationals with no less than 51 per cent of the registered capital. (Nikomborirak, 2004)
their inability to move up the value chain with their limited education and technological knowledge.

In terms of research, empirical studies have largely concentrated on the role of FDI in the manufacturing industry, as the largest recipient of FDI since 1970. Nevertheless, agriculture cannot be neglected because, given Thailand’s natural climate and resources endowment, it is likely to remain an agriculture-based economy. In addition, agriculture plays a key social and economic role as the employer of last resort, as observed in output growth and employment over time (see Figures 5.14 and 5.15). Thus, it is imperative to determine why FDI in the agricultural sector has been limited, how significant FDI has been to agricultural development in Thailand, and what have been or should be the government’s policies for promoting FDI in this sector.

While agriculture plays a significant role in the Thai economy, the sector’s FDI is kept at a modest level. Sattaphon (2006) found evidence that Japanese FDI had a positive, yet insignificant, effect on enhancing the growth process in Thai agriculture. However, other than that, the empirical evidence on the effect of FDI on agricultural growth and productivity is limited due to the weak presence of FDI in this sector.

5.3.3.2 Manufacturing. As a former agrarian economy, Thailand’s manufacturing growth has been impressive, expanding rapidly following the industrialisation programs that have concentrated on an export-oriented strategy since 1972. Manufactured products started to dominate Thailand’s export from the 1990s, as shown in Figure 5.16.
The manufacturing sector in Thailand employed almost 6.4 million workers in 2014, making it the third-largest employer sector (after agriculture, and wholesale and retail trade), accounting for 17 per cent of total employment by economic activity. Thailand’s main manufacturing exports have shifted from textiles, footwear and apparel in the early days to automobiles and automatic data processing currently. In 2014, the manufacturing sector accounted for 89 per cent of total exports (BOT Statistics, 2015).

Having faced many challenges over the decades—such as the 2004 tsunami, 2006 coup d'état, 2008 to 2009 GFC, 2011 major flooding, and another military coup in 2013—the manufacturing industry inevitably experienced a slowdown. However, as shown in Figure 5.17, the industry was less affected by the political events, and more

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The following political events have affected Thailand since 2006:

1. April to May 2006: Snap election called by the prime minister (PM) amid mass rallies against him. This is boycotted by the opposition.
2. September 2006: Military leaders stage a bloodless coup while PM Thaksin Shinawatra is at the United Nations General Assembly.
drastically affected by the 2011 flood, which swept across the major industrial sites in Bangkok. The sharp drop in the manufacturing index reflects the devastating result of the 2011 flood, which destroyed most of Thailand’s automobile industry and electrical and electronic industry. However, the industry recovered soon after due to a huge flow of financial aid and reinvestment from Japan.

![Figure 5.17. Effect of political turmoil on the real economy. Source: World Bank’s (2014) Thailand Economic Monitor.](image)

While manufacturing production has been significantly affected by the internal environment, FDI inflow to the manufacturing sector in Thailand appears to be more disturbed by global fluctuations, such as the GFC, which caused a huge drop in FDI in the following period (see Figure 5.18).


20 The World Bank estimated US$45.7 billion in economic damages and losses, which were mostly incurred by the manufacturing industry because seven major industrial estates were inundated by as much three metres of water during the floods (Middleton, 2012).

21 International funding reached over US$20 million from various donors, with Japan being the most significant, accounting for 68 per cent of funding (OECD Data, 2011).
Due to unsustainable growth in labour-intensive industries and increasing competition from neighbouring countries, the RTG has encouraged more FDI in capital-intensive industries, and provided higher incentives for manufacturing exports in Thailand. The significant growth of FDI in manufacturing exports in Thailand indicates the need for an empirical analysis of the effects of FDI on the manufacturing sector. A review of the literature indicates countless studies on FDI in different countries’ manufacturing sectors. A sectoral study based on Granger causality tests by Chakraborty and Nunnenkamp (2008) found that favourable growth effects of FDI in India were largely restricted to the manufacturing sector, where elasticities of output with respect to FDI were significantly higher than in the primary and tertiary sectors. Wang (2009) found strong evidence of the positive effects of FDI in manufacturing on economic growth. This study examined 12 Asian countries from 1987 to 1997, including Thailand. Meanwhile, Alfaro (2003) used cross-country data from 1981 to 1999 to examine the effect of FDI on different sectors, and found that FDI tended to

have a positive effect in manufacturing sector. These studies dominate the FDI literature because the positive effects of FDI appear stronger in manufacturing than in any other sectors. Theoretically, there are higher chances of spillover in more capital-intensive and sophisticated sectors than there are in labour-intensive and primary sectors because there are more linkages and direct involvement with technology.

Empirically, many studies have commonly found increases in TFP, factor growth and technological advancement in manufacturing, and confirm the theory (Alfaro, 2003; Aykut & Sayek, 2005; Chakraborty & Nunnenkamp, 2008; Nunnenkamp & Spatz, 2003; Puapan, 2014; Wang, 2009). Few studies have specifically examined Thailand. Based on Thailand’s significant share of manufacturing exports, Pupphavesa and Pussaransri (1994) applied the Granger causality test to examine the relationship between FDI and export in Thailand, and determined that FDI Granger causes the manufacturing export of Thailand. They concluded that the positive relationship means that FDI enhances exports in Thailand. This was supported by Tumbunlertchai (2009), who reasoned that foreign firms are more efficient and export more than do domestic firms. Wongpit (2008) examined the effect of FDI on manufacturing exports from Thailand using an extended gravity model, and reported that FDI has a positive effect on manufacturing exports from Thailand to other countries, while FDI is also complemented by manufacturing exports from source countries to Thailand. This aligns with Laoswatchaikul (2011), who also found evidence indicating that industrial FDI enhances domestic real wages and supports TFP in Thailand. Finally, Wang (2009) investigated 12 selected Asian countries, including Thailand, and found that FDI inflows have positive effects on the country’s economic growth. Importantly, FDI in the manufacturing sectors appeared to contribute to this growth the most.
Supported by the above range of literature reviews, the current study was expected to reflect the empirical study by Akapaiboon (2007), who found that the manufacturing sector’s output expanded after trade liberalisation in Thailand, while the agricultural sector’s output declined. This was probably because, as trade became liberalised, more agricultural products were imported from low-cost countries, such as China. As a result, domestic consumers purchased cheaper agricultural products from foreign countries, thereby causing local agricultural production to decline. Initially, the current study expected to find a positive relationship between FDI and growth in the manufacturing sector, but not in agriculture.

5.3.3.3 Finance. Prior to the 1997 crisis, Thailand’s domestic banks dominated the financial sector and formed a close relationship with local customers, while foreign bank participation was traditionally low. The AFC, which exposed the deficiencies in Thailand’s financial system, was the watershed event that left most domestic banks in a desperate search for large amounts of new capital. This capital could not be raised from local investors because they were also affected by the crisis. Thus, the after-effect of the crisis was a series of financial sector reforms in bank corporate governance, accounting practices, domestic bank regulation and supervision, and particularly the easing of restrictions of foreign ownership in the banking sector. As a result, four of 13 domestic banks in Thailand were sold to foreign investors, thereby increasing the share under foreign control from 0.5 per cent at the end of 1994 to 4.5 per cent at the end of 1999 (Mathieson & Roldos, 2001). After being granted better access, these foreign banks offered more diversified financial services to their customers. Consequently, their shares in the local market were expected to increase once they were settled, as was their influence on the domestic banking industries.
While increases in foreign participation in the domestic financial sector can accelerate improvements in banks’ operations and regulation (Goldberg et al., 2000), critics question the stability of industrialised country banks as lenders. First, financial sector FDI (FSFDI) raises concerns about increased exposure to economic occurrences in the countries of investment origins. Second, the level of foreign entry in the domestic market has been carefully examined because foreign companies are far more complicated to supervise (see Dale, 1984). Moreover, international banks have access to various investment alternatives, and thus have greater tendency to abruptly exit the country when a worsening economic environment reduces their profitability or increases their risk.

For these reasons, foreign companies are often feared in terms of undermining local financial markets. Thus, the issue of openness to foreign participation in domestic financial systems is debatable. However, a brief examination of the past two decades of Thailand’s financial sector indicates that there has been relatively steady growth since its recovery from the crisis. Figure 5.19 demonstrates Thai financial sector growth measured by chain index, and the values of GDP at current prices, with 2002 as the reference year. The figure highlights the lowest point of Thailand’s financial sector immediately after the 1997 crisis, the sector’s recovery in the following year, and the sector’s steady growth since.
Although Thailand has historically relied on FDI as an important part of its industrialisation and export-led growth, FDI in the financial sector has been relatively modest due to considerable restrictions on foreign participation in finance and banking before the 1997 crisis. These restrictions were relaxed after the crisis, leading to a significant surge of foreign bank participation and market share (see Figure 5.20). According to Bin (2003), in his review of ASEAN countries’ experiences in their financial sectors over the decade, foreign banks’ share of the total banking assets in Thailand have doubled since the crisis.

*Figure 5.19.* GDP growth in the financial sector, chain volume measures (reference year of 2002). Source: NESDB database (2015).
Recovery in the financial sector via foreign participation after the crisis was due to a combination of the fall in the number of local banks, the large write-off of local banks’ non-performing assets, and the liberalisation of foreign investment restrictions and acquisition by foreign banks. The restrictions on FSFDI were liberalised to various degrees across the ASEAN countries, and foreign bank participation rose strongly in terms of the share of banking assets, especially in Thailand and Indonesia. In an attempt to re-capitalise the banking sector, the Thai government lifted foreign shareholding limits on banks from November 1997 for a period of 10 years. During this period, foreign investors were permitted to hold more than 49 per cent of the share for up to 10 years, compared to only 25 per cent pre-crisis, resulting in a surge of foreign banks’ acquisition of local banks in 1997 to 1999 (Bin, 2003). This policy was somewhat positive in bringing back foreign investors; however, the change was not sustainable.
Fear of foreign domination eventually caused the government to reinstate the old restrictive policies, resulting in a drop in FDI in the later year.

The post-AFC period of 1999 to 2008 was characterised as a time of important reform in Thailand’s financial sector that led to significant growth in FDI, especially in the manufacturing sector. However, after this 10-year period ended, FSFDI started to decline and continued a downward trend throughout the GFC. This slowdown was caused by strong resistance to foreign ownership, which was refuelled after the first series of foreign bank entries, and made the government reluctant to further sell insolvent local banks to foreign capital. During this period, incoming foreign banks reported substantial administrative burdens, minimum capital requirement, stringent conditions for banking operation, high fees, ownership restrictions, and lack of transparency and certainty in legal and tax areas. The government’s actions appear to be contradicting the reformation plans initially suggested by the IMF. The painful experience of the 1997 AFC left Thailand overly cautious in its international dealings. However, progress has been made, and the country’s attempts to stabilise its financial sector have earned some approval from international organisations, such as the IMF and OECD. Nevertheless, due to Thailand’s protective nature, it has not yet been successful in achieving a competitive financial sector. To this day, the five leading domestic commercial banks control over 60 per cent of the retail banking market, with limited competition. In an attempt to renew competition and efficiency, the Financial Sector Master Plan (2010–2014) was created to make the financial market more accommodating to foreign investors’ participation. The FDI data show a return of FSFDI inflow after the plan was implemented (see Figure 5.21). Although the inflow of FSFDI has been fluctuating in recent years, it still holds a significant share of total FDI into Thailand—second only to manufacturing.
Figure 5.21. FDI classified by business sector of Thai enterprises (US$ millions).


As observed from the above figure, apart from manufacturing, the financial sector has attracted the most FDI, on average, for the past decade. Thailand appears eager to attract FDI because it enables the country to achieve higher economic growth; however, there are concerns about the dominance of competitive FDI, especially in financial service industries. To resolve these conflicting issues, the government has applied both promotion and protection policies. However, current policies are complicated and conflicting because they use both incentives\(^\text{22}\) and restrictions\(^\text{23}\).

In the banking sector, potential new foreign entries are considered under the *Financial Institutions Development Act*, which highlights majority ownership restrictions; strict licensing requirements; and other regulatory obligations, such as:

\(^{22}\) BOI incentives include tax incentives, permissions and guarantees (against nationalisation, competition and more) (see the Department of State’s *Investment Climate Statement* 2014 for details).

\(^{23}\) The current regulations state that a foreign company can own just 25 per cent of a Thai bank, or 49 per cent with permission from the Bank of Thailand. Beyond that, the buyer must receive approval from the finance ministry (Thai Embassy, 2015).
• limitations on the number and location of foreign banks’ operating overseas branch offices (maximum of two, including a headquarters office)
• rules on the minimum capital requirement and origin of assets
• restrictions on the number of foreign employees
• high joining fees for the retail payment system (European Commission, 2014).

Incoming foreign banks have also reported substantial administrative burdens and lack of transparency and certainty in legal and tax areas. According to the European Commission’s (2014) report on Thailand’s market access, five major domestic-owned commercial banks control over 60 per cent of Thailand’s retail banking market, with limited forms of competition. Overall, FSFDI increased in Thailand after the AFC, but the scale of FDI is more limited than in other countries. The slowdown occurred after the first series of investment, and banks were not always major players due to remaining regulations on FSFDI and limited foreign bank activities in Thailand. Thus, further attempts to restrict foreign ownership may negate BOI incentives and weaken Thailand’s investment environment. The main issue concerns the benefits and costs yielded by the openness of the financial sector. Apart from spillover effects, foreign presences create higher competition and force local banks to become more efficient. However, the positive effect can be weakened due to the additional risks for local banks in dealing with foreign competition. In tandem with the two sides of the argument, this study’s sectoral analysis attempts to determine the effect of FDI on Thailand’s financial sector growth. While there has been noticeable increase in FSFDI, specific research has been rare in the case of Thailand. Thus, this study’s empirical results for FSFDI will offer a significant contribution to fill this gap in Thailand’s FDI literature.
5.3.3.4 Hotels and restaurants. The growth of the hotel and restaurant sector—largely driven by tourism and increasing globalisation—is a significant aspect of the service sector. Indeed, tourism is now recognised as Thailand’s most important service industry, according to the Tourism Authority of Thailand (2012). Recent data show that this growing sector accounted for seven per cent of total employment in 2014. Moreover, the sector’s labour force is significantly increasing in size, following the agriculture and manufacturing sectors.


24 Tourism is not a traditional industry and is not readily identifiable as its own sector in the National Account. Hotels and restaurants are subsumed under tourism, and represent the largest share of tourism expenditure in Thailand; therefore, they are considered interchangeably in this discussion.

25 The definition of the services sector by the NESDB covers eight subsectors, and regards hotels, restaurants and tourism as one and the same. The service subsectors are: (i) electricity, gas and water supply; (ii) construction; (iii) wholesale and retail trade; (iv) hotels and restaurants (tourism); (v) transport, storage and communication; (vi) financial intermediation; (vii) real estate, renting and business activities; and (viii) other services (such as education and health).
Given that tourism is a labour-intensive industry that requires varying degrees of skill, it provides a significant source of employment and relatively easy entry into the workforce. Accordingly, tourism has become a priority for many countries and now accounts for over 30 per cent of total world export service.\textsuperscript{26} Growth in the tourism industry is generally measured by inbound tourism. Figure 5.23 illustrates the growth of Thailand’s international tourism, measured by the number of tourist arrivals from 1995 to 2012.

![Thailand's international tourism, in number of arrivals (1995-2012)](image)

\textit{Figure 5.23.} Thailand’s international tourism, measured by the number of tourist arrivals (1995–2012). Source: World Tourism Organization (2014), Yearbook of Tourism Statistics.

Thailand’s tourism industry has managed to remain relatively resilient in recent years, despite the country’s political disorder and uncertain global conditions, marked by weak global economic growth, the GFC and macroeconomic tensions in many

\textsuperscript{26} Tourism is measured in GDP as the output generated by industries that directly serve tourists’ needs (from airlines and travel agents to other passenger transport services), as well as all activities related to hotel and restaurants (see the World Travel and Tourism Council’s \textit{Travel and Tourism Economic Impact 2014} for details).
countries. In fact, the sector has benefited from increasing globalisation, and received increasing numbers of tourist arrivals due to higher purchasing power of the expanding middle class in many developing countries. In this context, tourism is regarded a critical sector for economic development in Thailand. Thailand also has an advantage in the region because it is positioned as a regional base from which international tourists can travel to other CLMV countries. Thailand has outperformed all other ASEAN countries in terms of tourist arrivals, as demonstrated in Figure 5.24.

![Figure 5.24. Number of tourist arrivals in ASEAN 10 (2009, 2011 and 2013). Source: ASEAN Tourism Statistics Database (2015).](image)

Moreover, Thailand is positioned well against countries outside the region. Thailand’s tourism receipts grew by 24.4 per cent in 2013, corresponding to an increase of 18.8 per cent in the number of tourist arrivals. In terms of ranking against other countries, Thailand ranks in the world’s top 10 for both international tourist receipts (sixth in 2013) and number of tourist arrivals (10th in 2013), according to the World Travel and Tourism Council’s (WTTC’s) Travel and Tourism Economic Impact (2014).
Figure 5.25. Top 10 global ranking for international tourist receipts in 2013. Source: WTTC Travel and Tourism Economic Impact (2014).

Although tourism is a large industry in many countries, with a significant role in job creation, it appears to be one of the least globalised. In contrast to the common perception, tourism FDI (TFDI) is still relatively low compared to FDI in other economic activities. This is partly because a large amount of TFDI is concentrated in selected activities covered by the definition of tourism—namely, hotels and restaurants—while a small amount of TFDI goes to sophisticated activities, such as tour
operations, reservations systems and airlines. According to the WTTC, tourism in Thailand contributes to nine per cent of direct GDP, 20.2 per cent of indirect GDP, 16 per cent of total exports and 15.3 per cent of total employment. However, the hotel and restaurant sector has managed to attract a relatively small amount of FDI, which appears to be highly fluctuating.

![FDI in hotels and restaurants (US$millions)](image)

Figure 5.27. Thailand’s FDI in hotels and restaurants, measured in millions of US dollars (2005–2014). Source: BOT (2015).

Thailand’s tourism industry surfaced during the country’s transition from a resource- to labour-based economy. With the belief that it was well equipped for tourism development, Thailand pursued a marketing plan that promoted high-cost to low-cost mass tourism nationwide. The plan was achievable because training was low-cost and resource input for tourism services was simple and not as extensive as that required for other types of industries. The view that tourism is a fast track to economic growth is commonly shared among developing countries. Not only do they believe tourism to be an effective means of creating job opportunities and increasing national
income, but they also assume that tourism development requires less investment than other industries. Thus, this study suspects that the growth in this sector has not been as FDI-focused as that in other sectors.

Due to the anticipated multiplier effects of the tourism sector on other economic sectors, several researchers have examined a tourism-led growth hypothesis (which is similar to the export-led growth hypothesis), which postulates that tourism can be an important determinant of overall long-term economic growth (Brida & Pulina, 2010; Gunduz & Hatemi, 2005; Panagiotidis et al., 2012). Most studies have confirmed the tourism-led growth theory. Gunduz and Hatemi (2005) found that this theory was supported empirically in Turkey, as did Balaguer and Jordá (2002) in Spain, Fayissa et al. (2008) in Sub-Saharan African countries, Seetanah (2011) in 19 island economies, and Tiwari (2011) in 4 ASIAN countries (India, China, Pakistan and Russia). Overall, the empirical findings emerging from the existing literature provide evidence that tourism activity does drive economic development in all the analysed countries.27

However, while there is substantial support of the positive effects of tourism on economic growth in the aforementioned studies (Balaguer & Jorda, 2002; Fayissa et al., 2008; Gunduz & Hatemi, 2005; Seetanah, 2011; Tiwari, 2011), there is relatively little evidence of FDI’s effects on the growth of tourism sector itself. This is partly due to unclear classifications of tourism activities, which make TFDI harder to assess. According to UNCTAD, many countries fail to appropriately classify TFDI because tourism is a sector arranged by economic activities that has not been identified at the highest levels of aggregation. The disaggregated data collected through various economic statistics provided by state administrations appear in many publications of international organisations, such as the UNCTAD, OECD, IMF and Commission of the

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27 See Brida and Pulina (2010) for a comprehensive literature review on the tourism-led growth hypothesis.
European Communities. The inconsistency of these data leads to inaccurate measurement of the total amount of TFDI in a country. Many cases reveal statistical discrepancy on the same FDI concepts published by various international organisations, while other cases do not employ the same international statistical standards to measure specific countries’ FDI (UNCTAD, 2007).

Like every country, Thailand has several definitions of the services sector, depending on derivation and terms of use (Koonnathamdeed, 2013). The main concern here is that Thailand’s NESDB definition of the services sector is different to that offered by the General Agreement on Trade in Services. While the NESDB classifies hotels and restaurants as a major service activity, the General Agreement recognises them as a part of tourism and travel. Multiple definitions prove a major challenge for researchers and policymakers, where data collection and systematic analysis becomes a gruelling process, which generates high transaction costs of obtaining more information about particular services, such as tourism and recreational services.

<table>
<thead>
<tr>
<th>Service sector: NESDB concept</th>
<th>Scope of services: GATS concept</th>
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<tbody>
<tr>
<td>1. Electricity, gas, and water supply</td>
<td>1. Business services</td>
</tr>
<tr>
<td>2. Construction</td>
<td>2. Communication services</td>
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<tr>
<td>3. Wholesale and retail trade; repair of motor vehicles, motorcycles, and personal and household goods</td>
<td>3. Construction and related engineering services</td>
</tr>
<tr>
<td>4. Hotels and restaurants</td>
<td>4. Distribution services</td>
</tr>
<tr>
<td>5. Transport, storage, and communications</td>
<td>5. Educational services</td>
</tr>
<tr>
<td>7. Real estate, renting, and business activities</td>
<td>7. Financial services</td>
</tr>
<tr>
<td>8. Public administration and defense; compulsory social security</td>
<td>8. Health-related and social services</td>
</tr>
<tr>
<td>9. Education</td>
<td>9. Tourism and travel-related services</td>
</tr>
<tr>
<td>10. Health and social work</td>
<td>10. Recreational, cultural, and sporting services</td>
</tr>
<tr>
<td>11. Other community, social, and personal service activities</td>
<td>11. Transport services</td>
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<tr>
<td>12. Private households with employed persons</td>
<td>12. Other services not included elsewhere</td>
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*Figure 5.28. Definitions of the services sector. Source: Koonnathamdeed (2013).*
As far as this study could determine, there has been no prominent research on Thailand’s TFDI’s effects on growth. However, there are a few studies worthy of note for larger economies, such as China and India, where the tourism industry is considered a very significant aspect of the economy. In China, Tang et al. (2007) investigated the causal relationship between FDI and tourism from 1987 to 2001, and found a one-way causal relationship from FDI to tourism, while Selvanathan et al. (2009) found that FDI plays a significant role in expanding the tourism sector in India. In contrast, multi-country studies have found mixed results. Salleh et al. (2011) examined the relationship between the development of the tourism industry (tourist arrivals) and FDI in five selected Asian countries: Malaysia, Singapore, Thailand, China and Hong Kong. Overall, cointegration/long-term relationships between variables were found for all five countries. However, a bidirectional relationship between tourist arrivals and FDI was found only for Hong Kong, while a unidirectional relationship was found for Thailand and Malaysia, and no significant relationship was found for Singapore or China.

According to this study, FDI has a positive effect on Thailand’s tourism, but tourism does not necessarily induce greater FDI.

Tourism is a complex industry that can benefit economic development by providing a series of forward and backward linkages. However, there this industry has an ‘Achilles’ heel’ because it is inevitably exposed to external forces, such as foreign exchange rate fluctuations, economic crises, natural disasters, political disputes, terrorism and a negative image caused by malpractice. The development of the tourism industry, which depends on investment, must withstand such negative influences. Key development areas in infrastructure (namely, utilities, telecommunications and transport) often require larger investments that may be met by FDI, especially for developing countries, which can lack the necessary capital. Recognising that Thailand’s
prolonged period of political conflict in recent years has caused vital infrastructure spending to be delayed or overlooked, the government plans to increase its spending on infrastructure to lift the stagnating economy, after almost zero growth in 2014. This projection highlights the government’s seven-year spending plan of over US$100 billion on railway upgrades and water management.

**5.3.3.5 Electricity and utilities.** Utilities refer to essential services—namely, water, electricity and gas—which play a vital role in economic development. However, unlike in hotel services, the utilities sector is characterised with adult male dominance. The employment in this sector requires specific skills and experiences, which makes it less accessible and attractive to young men and women. Further, there are severe cases of gender and age imbalance in some occupations, which leads to a challenge for human resource management, given Thailand’s ageing society—that is, it will be difficult to replace the ageing workforce in the near future. The utilities sector shows a long-term declining trend in its contribution to GDP growth, as shown in Figure 5.29.

*Figure 5.29. Thailand’s electricity and utilities sector contribution to GDP growth (1991–2014). Source: NESDB Database (2014).*
The growth of this industry mismatches its consumption demand. Thailand’s electricity imports have more than tripled in the past decade as a result of rising electricity demand and transmission interconnections with nearby countries. Consequently, Thailand has become dependent on energy imports from its neighbours, especially electricity imports from Laos PDR and natural gas imports from Myanmar. Importantly, natural gas accounted for almost 70 per cent of total fuel consumption for electricity generation in 2012. This share of energy imports consumes almost 12 per cent of the GDP, and raises concerns as an economic burden that drives up domestic utility costs. In line with the sector’s growth, the FDI inflow into Thailand’s utility sector also shows long-term decline.

![FDI in electricity and utilities sector](image_url)

*Figure 5.30.* Thailand’s FDI in electricity and utilities sector, measured in millions of US dollars (2005–2013). Source: BOT Database (2014).

Thailand still faces a large challenge in developing its electricity and utilities industry. There is huge potential for FDI to fill this gap, which is lacking the necessary funding for investment. However, change in policy to promote further FDI in this sector requires government reconsideration of the significant restrictions on FDI that it has formerly imposed to protect local firms from foreign competition. Importantly,
electricity generation and transmission are essential to infrastructure, consumers and industries. Therefore, access to electricity is closely linked to the state developmental plans, and electricity is often regarded a political commodity in Thailand. Figure 5.31 shows that the electricity and utilities sector is subjected to the same FDI restrictions for local market access as are the agricultural, finance and service sectors.

<table>
<thead>
<tr>
<th>Thailand's market access restriction on FDI by sector</th>
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<tbody>
<tr>
<td>Finance</td>
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<tr>
<td>Hotels and restaurant</td>
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<tr>
<td>Electricity and utilities</td>
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<tr>
<td>Manufacturing</td>
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<tr>
<td>Mining and quarrying</td>
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<tr>
<td>Agriculture, forestry and fishing</td>
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</table>

*Figure 5.31*. Thailand’s FDI restrictions, measured by market access. Source: Urata and Ando (2010).

Contrary to the manufacturing sector, the electricity and utilities sector faces considerable restrictions in terms of market access. The electricity sector in Thailand is dominated by the state-owned Electricity Generating Authority of Thailand (EGAT)—the largest and only generator that has the lawful right to purchase power from other private producers, both domestically and abroad. Under government regulations, the EGAT is also the only generator authorised to distribute electricity to retailers. Further, retail markets are also under the monopoly of the Metropolitan Electricity Authority of Thailand, which provides electricity in Bangkok, and the Provincial Electricity Authority of Thailand, which supplies electricity to the rest of Thailand.
Lack of competition and capital investment under government restrictions not only affects electricity, but also other utilities industries. For example, the main water supply in Thailand is provided by the Local Waterworks Department. However, this supply of water is not directly consumable, and most households access groundwater via holding tanks or sunken wells for their main water supply. Importantly, many rural areas are still lacking an adequate supply of safe drinking water and proper sanitation. This issue continues to suppress Thailand’s rural development and people’s quality of life, and should be a government priority. In summary, to resolve many issues in the electricity and utilities sector, old systems require upgrading and new infrastructure must be built. This will require large amounts of capital and technology, which has been made possible in other areas through FDI. This highlights the argument that infrastructure development and FDI must go together because, without contemporary infrastructure in utilities, there is no incentive for new capital to enter via domestic or international entities.

5.3.3.6 Sector-specific benefits. One of the key issues found in all sectors is the need to determine the sector-specific benefits received from FDI in order to revise FDI-related policies that can be instrumental in meeting the demands and needs of each sector. Currently, the manufacturing sector’s share to GDP has improved considerably against the weakening performance of the agriculture sector in past decades. In order to enhance this growth more effectively, the Thai government has implemented liberalised policies to attract much-needed financial capital. However, most of these capital investments are directed to the manufacturing sector. To create the optimal spillover effects for the country’s sustainable development, FDI must be directed to the appropriate sectors. Against this backdrop, this study believes it is most important to analyse Thailand’s sectoral FDI, where the relationship is examined in terms of the role
FDI inflows play in promoting growth in the main economic sectors. The main questions to answer are:

1. Can any significant unidirectional or bidirectional relationship be found between Thailand’s inward FDI and economic growth?
2. How effective has the Thai government’s FDI policy been in stimulating investment and growth in the key sectors of the economy?
   a. Has there been sufficient growth in the manufacturing sector to justify its excessive investment privilege over other sectors?
   b. Has the previous focus on tourism been rightly placed as a main driver of Thailand’s economic growth?
3. What are the areas on which the government and policymakers should focus to enable more sustainable economic development for Thailand’s future?

Mindful of the possible variations arising from incomplete data and the other limitations of this study, the results from this empirical analysis should provide a clearer idea of which sectors best respond to investment, and which have the highest potential gain from future FDI.

5.4 Empirical Analysis of FDI’s Effect on Thailand’s Economic Sectors

While there is broad awareness and continuous literature on the FDI–growth nexus, the conceptual complexities and data availability often complicate qualitative assertions of the contribution of FDI to growth. However, an empirical analysis was imperative for this study because the results may have important implications for Thailand’s economic growth and development. That is, if FDI inflow has a significant effect on sectoral output, then FDI that is channelled properly can be used as an engine of growth in order to maximise total output and propel Thailand to the next stage of its development.
In an attempt to quantify the contribution of FDI for Thailand, this study applied a simple regression to analyse the importance of FDI in promoting the growth of nine subsectors of the economy: construction, manufacturing, finances, wholesale and retail trade, agriculture, transport, electricity, real estate, and hotels and restaurants. If the transfer of new technology and skills is one of the positive effects of FDI, one might expect the relationship between FDI and growth to be stronger in sectors with higher skill requirements. Sectors such as manufacturing were expected to have a significantly stronger positive relationship between FDI and growth than were sectors such as agriculture. This was because the agricultural sector tends to have lower income elasticity of demand, compared to the manufacturing sector. In other words, the agricultural sector was expected to have declining returns, while the manufacturing sector was expected to have increasing returns.

Apart from using FDI as the main variable of interest, this study’s rational of choosing the other selected variables was as follows. Employment and capital formation were naturally included in the model derived from the Cobb-Douglas production function, while exports were selected because Thailand is an export-led economy. A dummy variable (crisis) was included to control for the financial crises that affected Thailand’s economic growth during the period of observation (2005 to 2014). This study hypothesised that the determinants of sectoral output included FDI, employment, exports, and other economic events presented by control variables (such as crisis and capital formation). In stylised form, the model was as follows:

\[ \text{Sectoral Output}_{i,t} = \text{Constant} + FDI_{i,t} + \text{Employment}_{i,t} + \text{Crisis}_t + \text{Exports}_{i,t} + \text{Capital Formation}_t + \epsilon_{i,t} \]

Table 5.4 summarises the data used to measure output growth, and their respective sources.
Table 5.4

*Summary of Data Sources (2005–2014)*

<table>
<thead>
<tr>
<th>Variable</th>
<th>Definition</th>
<th>Data source</th>
</tr>
</thead>
<tbody>
<tr>
<td>Output</td>
<td>GDP by sector</td>
<td>NESDB</td>
</tr>
<tr>
<td>FDI</td>
<td>FDI classified by business sectors</td>
<td>BOT</td>
</tr>
<tr>
<td>Employment</td>
<td>Employed people by industry</td>
<td>NSO</td>
</tr>
<tr>
<td>Crisis</td>
<td>Dummy variable</td>
<td>N/A</td>
</tr>
<tr>
<td>Export</td>
<td>Export classified by product groups</td>
<td>BOT</td>
</tr>
<tr>
<td>Capital formation</td>
<td>Gross fixed capital formation</td>
<td>NESDB</td>
</tr>
</tbody>
</table>

Note: * all variables are in quarterly data.

The expected relationships between output and the explanatory variables were as follows. FDI should have positive relationship with output. Significant results were expected in sectors that receive a sizeable inflow of FDI. Employment should increase output in labour-intensive sectors, while capital formation should increase output in capital-intensive sectors, and crisis should negatively affects output.

Table 5.5

*Electricity and Utilities Sector Estimation Results*

<table>
<thead>
<tr>
<th>Variable</th>
<th>Coefficient</th>
<th>Standard error</th>
<th>T-statistic</th>
<th>P-value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Constant</td>
<td>0.2941</td>
<td>1.7716</td>
<td>0.02</td>
<td>0.987</td>
</tr>
<tr>
<td>FDI</td>
<td>-0.0486</td>
<td>0.0508</td>
<td>-0.96</td>
<td>0.347</td>
</tr>
<tr>
<td>Employment</td>
<td>-0.1919</td>
<td>0.1492</td>
<td>-1.29</td>
<td>0.021</td>
</tr>
<tr>
<td>Crisis</td>
<td>-0.0858</td>
<td>0.0568</td>
<td>-1.51</td>
<td>0.143</td>
</tr>
<tr>
<td>Exports</td>
<td>-0.3750</td>
<td>0.2708</td>
<td>-1.38</td>
<td>0.177</td>
</tr>
<tr>
<td>Capital</td>
<td>1.0252</td>
<td>0.2585</td>
<td>3.97</td>
<td>0.000</td>
</tr>
</tbody>
</table>

No. of observations: 33
R-squared: 0.5185
Adjusted R-squared: 0.4293
F (5, 27): 5.82
Durbin-Watson stat.: 1.8246

Note: The least squared regression, dependent variable is utility sector output, spanning 2005 to 2013. The model corrects for serial correlation in the residual using Prais-Winston (1954) transformation.

Table 5.5 presents the results for utilities. The main variable of interest was FDI, which indicated no statistically significant relationship between FDI and output in the utilities industry. Crises, exports and employment were also statistically insignificant.
The insignificant results in this sector were expected due to the insufficient amount of FDI inflow. Similar results were found by Kahliq and Noy (2007) for Indonesia, Usiri (2014) for Tanzania and Puapan (2014) for Thailand.

Table 5.6

Manufacturing Sector Estimation Results

<table>
<thead>
<tr>
<th>Variable</th>
<th>Coefficient</th>
<th>Standard error</th>
<th>T-statistic</th>
<th>P-value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Constant</td>
<td>0.5002</td>
<td>1.4478</td>
<td>0.35</td>
<td>0.732</td>
</tr>
<tr>
<td>FDI</td>
<td>0.2751</td>
<td>0.3004</td>
<td>0.92</td>
<td>0.368</td>
</tr>
<tr>
<td>Employment</td>
<td>1.1325</td>
<td>0.2106</td>
<td>5.38</td>
<td>0.000</td>
</tr>
<tr>
<td>Crises</td>
<td>-0.0361</td>
<td>0.0363</td>
<td>-0.99</td>
<td>0.329</td>
</tr>
<tr>
<td>Exports</td>
<td>0.6046</td>
<td>0.1738</td>
<td>3.48</td>
<td>0.002</td>
</tr>
<tr>
<td>Capital</td>
<td>-0.0394</td>
<td>0.1561</td>
<td>-0.25</td>
<td>0.803</td>
</tr>
<tr>
<td>No. of observations</td>
<td>33</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>R-squared</td>
<td>0.7827</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Adjusted R-squared</td>
<td>0.7424</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>F (5, 27)</td>
<td>19.45</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Durbin-Watson stat.</td>
<td>2.5066</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

For the manufacturing sector, Table 5.6 highlights the positive relationship identified between exports and growth, and the significant relationship between employment and growth. Meanwhile, the main variable of interest (FDI) showed a positive, yet not statistically significant, relationship with output. The dummy variables of crises and capital formation were negative, yet not statistically significant. In contrast to past studies (Alfaro, 2003; Aykut & Sayek, 2005; Chakraborty & Nunnenkamp, 2008; Jongwanich, 2010; Nunnenkamp & Spatz, 2003; Puapan, 2014), the current study’s empirical results showed that, although FDI has a positive effect on Thailand’s manufacturing growth, it was not as significant as exports and employment effects. This is explainable by considering the effect of FDI to be conditional on the absorptive capability of the country, with Thailand’s low absorptive capability not allowing the sector to maximise the benefits of FDI on growth. Other possible reasons include reduced global demand and falling commodity prices that adversely affect
manufacturing growth, the recent political disturbances, and the major flood in 2011\(^{28}\) (included in the study observation period), which caused a major setback for the whole economy, with most damage done to the manufacturing industries. Nevertheless, the effect of FDI can be channelled through exports and employment effects, as suggested by Jongwanich and Kohpaiboon (2008), who examined the 1997 Thai manufacturing census and found that foreign ownership had a significant and positive effect on export participation for Thai manufacturing firms.

Table 5.7

*Agriculture Sector Estimation Results*

<table>
<thead>
<tr>
<th>Variable</th>
<th>Coefficient</th>
<th>Standard error</th>
<th>T-statistic</th>
<th>P-value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Constant</td>
<td>-4.4410</td>
<td>0.8861</td>
<td>-5.01</td>
<td>0.000</td>
</tr>
<tr>
<td>FDI</td>
<td>-0.5873</td>
<td>1.5160</td>
<td>-0.39</td>
<td>0.702</td>
</tr>
<tr>
<td>Employment</td>
<td>-0.6592</td>
<td>0.3162</td>
<td>-2.08</td>
<td>0.047</td>
</tr>
<tr>
<td>Crises</td>
<td>0.1963</td>
<td>0.0653</td>
<td>3.01</td>
<td>0.006</td>
</tr>
<tr>
<td>Exports</td>
<td>1.9093</td>
<td>0.3589</td>
<td>5.32</td>
<td>0.000</td>
</tr>
<tr>
<td>Capital</td>
<td>-0.3802</td>
<td>0.3601</td>
<td>-1.06</td>
<td>0.300</td>
</tr>
<tr>
<td>No. of observations</td>
<td>33</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>R-squared</td>
<td>0.8551</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Adjusted R-squared</td>
<td>0.8283</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>F (5, 27)</td>
<td>31.87</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Durbin-Watson stat.</td>
<td>1.8194</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Table 5.7 presents the results for Thailand’s agriculture sector, where the FDI variable appeared to be negatively related to the sector’s growth, although this was not statistically significant. The same can be said for employment and capital formation, which were also negative. This may be due to many reasons, such as over-protective regulatory policies, high restriction of FDI in the sector, and a subsequent declining share of FDI in agriculture compared to the manufacturing and service sectors. This result was not unusual, considering similar evidence found in Alfaro (2003), Nunnenkamp and Spatz (2003), Aykut and Sayek (2005), Kahliq and Noy (2007),

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\(^{28}\) In late 2011, severe flooding damaged 1,775 of the BOI’s existing promoted companies, worth a combined investment value of 624 billion baht (around US$21 billion) or roughly nine per cent of the total investment for the past 10 years (Department of State’s Investment Climate Statement, 2014, p. 13).
Charkraborty and Nunnenkamp (2008) and Puapan (2014). The only significantly positive results were for exports and crises, which may be due to government assistance and higher demand for primary products leading to expanded output.

Table 5.8

Hotels and Restaurant Sector Estimation Results

<table>
<thead>
<tr>
<th>Variable</th>
<th>Coefficient</th>
<th>Standard Error</th>
<th>T-statistic</th>
<th>P-value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Constant</td>
<td>-3.0338</td>
<td>0.4531</td>
<td>-6.69</td>
<td>0.000</td>
</tr>
<tr>
<td>FDI</td>
<td>0.1030</td>
<td>0.0326</td>
<td>3.16</td>
<td>0.004</td>
</tr>
<tr>
<td>Employment</td>
<td>0.3692</td>
<td>0.1786</td>
<td>2.07</td>
<td>0.048</td>
</tr>
<tr>
<td>Crises</td>
<td>0.0963</td>
<td>0.0303</td>
<td>3.18</td>
<td>0.004</td>
</tr>
<tr>
<td>Exports</td>
<td>0.3151</td>
<td>0.1526</td>
<td>2.06</td>
<td>0.049</td>
</tr>
<tr>
<td>Capital</td>
<td>0.789</td>
<td>0.1226</td>
<td>5.07</td>
<td>0.000</td>
</tr>
<tr>
<td>No. of observation</td>
<td>33</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>R-squared</td>
<td>0.9221</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Adjusted R-squared</td>
<td>0.9077</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>F (5, 27)</td>
<td>63.95</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Durbin-Watson stat.</td>
<td>1.9627</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Table 5.8 shows the results for the hotels and restaurants sector, where all interested variables were positively signed. The most significant variables were FDI and crises, reflecting an increase in tourism receipts with more FDI inflow, and continuous increase in the number of tourists, even during the period of global crisis. Meanwhile, employment and exports appeared insignificant, although they were both positively signed. These results suggest that the growth of hotels and restaurants may be driven predominantly by external factors. Similar results were obtained by Kahlilq and Noy (2007) for Indonesia and Puapan (2014) for Thailand.
Table 5.9

**Finance Sector Estimation Results**

<table>
<thead>
<tr>
<th>Variable</th>
<th>Coefficient</th>
<th>Standard error</th>
<th>T-statistic</th>
<th>P-value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Constant</td>
<td>-5.9098</td>
<td>1.4926</td>
<td>-3.96</td>
<td>0.000</td>
</tr>
<tr>
<td>FDI</td>
<td>0.0012</td>
<td>0.0027</td>
<td>0.45</td>
<td>0.653</td>
</tr>
<tr>
<td>Employment</td>
<td>0.0400</td>
<td>0.2271</td>
<td>0.18</td>
<td>0.862</td>
</tr>
<tr>
<td>Crises</td>
<td>0.1248</td>
<td>0.0523</td>
<td>2.39</td>
<td>0.024</td>
</tr>
<tr>
<td>Exports</td>
<td>0.8785</td>
<td>0.2242</td>
<td>3.92</td>
<td>0.001</td>
</tr>
<tr>
<td>Capital</td>
<td>0.6122</td>
<td>0.2372</td>
<td>2.58</td>
<td>0.016</td>
</tr>
<tr>
<td>No. of observations</td>
<td>33</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>R-squared</td>
<td>0.8237</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Adjusted R-squared</td>
<td>0.7910</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>F (5, 27)</td>
<td>25.23</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Durbin-Watson stat.</td>
<td>1.8041</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Table 5.9 shows that only exports and capital formation appear to be driving growth in the finance sector. The variable of interest, FDI, was not significant, although was positively signed. This was not unusual because the effect of FSFDI is more significant in a competitive environment. Thailand has strict regulations for foreign ownership of financial institutions that generally limit competition in order to protect inefficient domestic banks. Similar results were found in other studies of developing countries, such as those by Chakraborty and Nunnenkamp (2008) in India; Usiri (2014) in Tanzania; and Wang (2009) in 12 Asian countries, including Thailand.

**5.4.1 Summary of results.** In summary, the relationship between FDI and each sector’s growth appeared to be positive for all sectors, except agriculture, electricity and utilities, and transport. However, the only significant result obtained was in the hotel and restaurant sector, despite the small FDI inflow relative to other sectors. In contrast, the manufacturing sector did not respond as well as expected, given that this sector receives the most FDI. This suggests that FDI alone may be insufficient to create economic development, and that improving domestic institutions and workforce quality may be more effective.
Based on these results, it can be inferred that the service sector in Thailand, propelled by inflows of FDI, plays a significant role, with hotels and restaurants one of the most instrumental factors propelling the sector’s growth. The concern here is whether this type of growth will be sustainable in the longer term. Since the new trend for FDI in ASEAN has turned towards the service sector, economies that have already liberalised their services industry (such as Singapore) have been able to obtain most of the region’s FDI shares. Meanwhile, even though Thailand has moved from traditionally protecting its service sector and opened up to FDI, there remain considerable investment restrictions that need to be liberalised in order to take advantage of upcoming deeper economic integration.

Table 5.10

| Source: Urata and Ando (2010). |

<table>
<thead>
<tr>
<th>Restriction of FDI in the Service Sector in Six Areas</th>
</tr>
</thead>
<tbody>
<tr>
<td>Brunei</td>
</tr>
<tr>
<td>Market access</td>
</tr>
<tr>
<td>National treatment</td>
</tr>
<tr>
<td>Screening and appraisal</td>
</tr>
<tr>
<td>Board of directors</td>
</tr>
<tr>
<td>Movement of investors</td>
</tr>
<tr>
<td>Performance requirement</td>
</tr>
</tbody>
</table>

The above table compares the FDI restrictions\(^{29}\) in the service sector among the ASEAN countries in six areas: market access, national treatment, screening and

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\(^{29}\) Restrictions of foreign investment can take many forms and can either apply to all sectors or vary by sector. They can include limits on foreign equity ownership and land ownership; joint venture
appraisal, board of directors, movement of investors, and performance requirement. The scores represent an average of all service sectors, with higher values denoting higher restrictions imposed. According to the World Bank’s East Asia Pacific economic update (2014), ASEAN as a region imposes more stringent foreign ownership restrictions than do any other regions in the world. Importantly, Thailand is the most restrictive in the region, followed by the Philippines and Malaysia. Thailand is the only country without any restrictions for national treatment, boards of directors and performance requirements. However, it has the highest restrictions placed on the movement of investors and market access, thereby resulting in minimal FDI inflow to the sector. This is quite a contrast to the strategies of more successful countries such as Singapore, where lower restrictions are spread over all areas.

Overall, Thailand has the least open service sector in ASEAN. The country’s lagging service sector may also defer other service-related businesses, such as financial services and insurance, land transportation and logistics services. Thus, further service sector liberalisation may be beneficial in Thailand’s case. Of 9,410 applications submitted to the BOI during 2010 to 2014, 2,886 applications—worth more than 1,700 billion baht—were in services and public utilities. This trend demonstrates that great opportunities already exist in this area for investors. Despite considerable economic benefits to be gained, Thailand’s reluctance to fully liberalise its service sector will eventually cause economic growth to halt. According to the Thailand Development Research Institute, labour productivity in services is already lagging in some ASEAN member states, including Thailand. Indeed, simple observation indicates that the share of industrial output in Thailand’s GDP is the highest in Asia, while that of the service sector has become sluggish during the past five decades. This has mainly been caused

requirements; approval based on mixed criteria; reciprocity requirements; restrictions on profit and capital repatriation, or on branching and access to local finance; and screening mechanisms based on national security considerations, or for prudential reasons. See Urata and Ando (2010) for measurement details.
by low labour productivity and low FDI in services, resulting in a lack of technology transfer.

Thailand’s tourism industry is an example of how labour-intensive activity concentration presents a future challenge for Thailand. According to this study’s empirical results, Thailand’s tourism sector responds well to FDI, despite the small level of FDI received. The sector has outstanding performance in terms of providing jobs and generating income for a significant portion of the labour force. However, there are concerns that, while a low level of FDI has been sufficient for labour-intensive service industry in the past, further FDI will be needed for the next stage of development, especially for improving infrastructure and increasing competitive advantage in the tourism sector. The important point here is that, once Thailand’s first stage of tourism development (which relied on the natural environment) has been depleted, heavy capital investment will be required for infrastructure. Thus, future policies need to be designed to enable the next stage of development.

First, the government should support different aspects of tourism, such as medical, long-stay and cultural tourism, and develop information support and systems for tourists. Second, opportunities exist among higher-end consumers. Thailand should consider the types of tourists and the income they generate, rather than simply maximising numbers. This can be achieved by developing more sophisticated hotel, restaurant and other tourism services. Third, Thailand should develop niche markets and diversify products in order to minimise seasonal effects and reduce pressure on clustered destinations by distributing tourists to less travelled areas. There are many possible niche markets for Thailand, such as diving, extreme sports, festivals, homestays, soft adventures, culinary tourism and many more. For higher-end tourists, the Tourism Authority of Thailand (2012) suggested four niche products—golf, health
and wellness, weddings and honeymoons, and green tourism—to attract high spenders and expand the luxury market. Finally, the past development of the tourism industry in Thailand has been mostly attributed to private sector investment and efforts, while the public sector has been less active in upgrading infrastructure to keep up with the industry’s growth. In certain regions, the standards of public facilities—such as telecommunication, roads, water and electricity facilities—are deficient, not only for locals, but also for tourists and visitors. Meanwhile, for modernised areas such as Bangkok, there are cluster problems, such as heavy traffic congestion, which discourage people from contemplating a visit to Thailand. Again, this can be solved by diversifying and developing more niche products. All these considerations also suggest that FDI into areas such as utilities, ICT and infrastructure development may be more beneficial than receiving direct FDI into the tourism industry itself. This also includes investment in education, human resource development, training, and higher management skills, which can enhance tourism services and improve administrative policies on tourism.

Overall, tourism investment is a positive public policy; however, the future direction of the industry depends on many factors, including the level of competition, growth of ICT and transportation, and (most importantly) global economic and geopolitical stability. Based on this study’s empirical results, the low level of FDI in the tourism sector has not deterred growth, but rather has positively contributed to the sector’s growth. Relative to other sectors, tourism is quite self-sufficient and may need fewer incentives to attracting FDI. Thus, the government should continue to support the industry, and adjust its policies to ensure the best interests of the nation, as deemed necessary when changes in global settings occur.

For the financial sector, this study’s results showed that FDI has a positive, yet insignificant, effect on the sector’s growth. This is not unusual considering that the
effect of FSFDI is most significant in a competitive environment, and less so under restrictions, such as those imposed on Thailand’s FSFDI. In the wake of the 1997 AFC, Thailand’s financial sector has been open, yet cautious. During past decades, Thailand has been alternating between financial liberalisation and capital controls. During this time, the BOT has been criticised for heavily regulating financial service charges, leading to low competition and high costs for customers.

While the domination of Thai lenders allows the banking sector to be well capitalised and liquid, it also means lower competition in the market, which offsets any increase in competitiveness associated with an increase of foreign participation in the Thai banking system. In this case, even though the sector succeeded in attracting the highest FDI inflows in the first nine months of 2013 (39.1 per cent of the total), surpassing manufacturing (29.4 per cent) and real estate (11.3 per cent), the effect of FSFDI is not as significant as it should be. Further, since the Thai parliament dissolved in 2013 following the military coup, and the national election was annulled in 2014, the BOI’s ability to issue new investment licences has been immobilised because new board members cannot be appointed without legislative approval. This matter needs to be immediately resolved and issuing licenses needs to be renewed, even if the political impasse continues.

Based on these results, this study believes that there is considerable scope to lower the restrictions in the banking sector in order for Thailand to take better advantage of the rise in FSFDI, which will play an increasingly significant role in the future as the country moves towards its next stage of development. However, lowering restrictions must work in tandem with increasing competitiveness and strengthening financial markets overall—specifically, improving the legal framework, risk assessments and increasing financial literacy among consumers and investors must be prioritised. The
agriculture and utilities sectors are subjected to the same degree of market access restrictions for FDI, yielding similar results of an insignificantly positive effect of FDI on these sectors’ growth. Of all sectors, Thailand’s manufacturing has the least restrictions, resulting in the highest FDI inflow throughout previous decades, yet the effect of FDI is not significant.

In determining the degree of restrictions in different countries and sectors, Urata and Ando (2010) investigated the FDI environment of ASEAN countries by conducting a survey of Japanese firms. They discussed the problems and obstacles faced by Japanese firms related to FDI liberalisation and facilitation. According to the survey, the most reported incidents in Thailand included complicated and delayed procedures, lack of transparency in investment policies and regulations, restrictions on foreign entry, underdeveloped infrastructure, shortages of human resources, and insufficient investment incentives (Urata & Ando, 2010). Since Japan is Thailand’s leading foreign investors, these reported incidents have significant implications for the economy, and represent areas in which the government can improve. Finally, the discrepancies between the results of FDI to these sectors are very important with respect to their implications for local institution building and national development policies. These differences, more so than the similarities, should be the focus of research concentration and policymaking. Based on these findings, Figure 5.32 presents the existing BOI incentives given to different sectors.
Past BOI investment promotion activities have been primarily concentrated in the manufacturing sector; however, it is arguable that other sectors—such as the service and utilities sectors—have high potential, and BOI should focus its efforts on them. Currently, almost 50 per cent of the country’s labour force is in the services sector, while only 16.8 per cent is in the manufacturing sector. This raises doubts about the government’s heavy support of the latter. The incentives given to foreign investors specialising in high-tech and export-oriented manufacturing industries outweigh the incentives given to domestic investors specialising in low-tech and local-market-oriented industries, resulting in an unhealthy dual economy and further widening of the income gap.

The main challenges for the government are to revise all FDI incentives and benefits, enhance the responsiveness of education and training systems to the changes in skill requirements for each sector, and generally improve access to training and skills development. Ultimately, the country’s advancement depends largely on workers’ skills and knowledge, which determines the country’s level of absorptive capability necessary for maximising the benefits of FDI on economic growth. This suggests that a shift away...
from labour-intensive services to higher skill and human capacity development in sectors such as education and health may yield more future benefits and increase growth opportunities for Thailand. Nevertheless, the evidence that Thailand should target certain sectors needs to be weighed against the bureaucratic costs and increased potential for corruption in differentiated schemes.

5.5 Conclusion and Recommendations

Acknowledging that FDI in Thailand is focused in specific industries, this study undertook a sectoral analysis to identify the effect of FDI on different sectors’ growth. The results confirmed that the potential positive or negative effects on the economy depend on the nature of the sector in which investment takes place. The most significant result was found in the hotels and restaurant sector. Viewed as a service sector that represents Thailand’s tourism, this sector is already performing well with minimal FDI inflow. To improve its sustainability in the future, guided by globalisation, the government should concentrate on developing more sophisticated products and services for higher-end consumers.

For the manufacturing sector, there are sufficient FDI incentives to attract international investors. However, the effect of FDI is lower than it should be, which may be attributed to a number of possible reasons, such as low absorptive capability, lack of skills and limited spillover effects. These problems can be resolved by improving the educational system, promoting domestic inputs to support local suppliers, and increasing the government’s focus on S&T.

The results for the agricultural sector suggested that the sector’s limited FDI does not match the needs of the food-processing industry, which has done exceptionally well in attracting FDI. Ideally, given that agricultural output is the main input for this type of manufacturing industry, the two sectors should prosper together. Otherwise,
increases in FDI in the food-processing industry will likely lead to increases in imports for production. Under existing conditions, that government strongly promotes the food industry for foreign investors, while upholding considerable restrictions on the agriculture sector. This policy has resulted in large discrepancies in terms of FDI inflows and sector growth rates. Moreover, a large income (per capita) gap between these two sectors has caused a shift in employment from agriculture to manufacturing. To respond to these changes in the industrial structure, further education and vocational training is required. In addition, moderating restrictions and promoting local agricultural products will help return balance to these sectors.

For other sectors with positive yet insignificant results, such as finance and electricity and utilities, this study suspects that insufficient FDI and low competition are the main causes for these results. For the sectors with negative results, further investigation is needed to explain the relationship between FDI and growth.

Finally, aside from Thailand’s deficient infrastructures and shortage of skilled workers, its political uncertainty is regarded by some firms as an obstacle to investment. Frequently asked questions about the political situation in Thailand concern whether there will be civil disobedience, a *coup d'état* or an early election in the foreseeable future. For the past decade, Thailand’s political impasse has resulted in frequent replacement of the government, rendering most development plans defunct. For example, Thailand’s strong logistics sector and long-term competitiveness are threatened by recurring political turmoil. The RTG has repeatedly failed to implement its major transport development plan, impelling investors to seek alternative locations, such as Malaysia and Vietnam, as new manufacturing hubs that offer better supply chain opportunities. For example, South Korea’s LG Electronics Inc., which ranks second in the global television market, has announced plans to shift television
production from Thailand to Vietnam, where labour costs are cheaper and China-based suppliers are closer (Reuter, 2015). Other MNEs are postponing investment plans, while some are considering countries outside of Thailand, such as Malaysia. Despite the central bank’s efforts to boost the economy with interest rate cuts in both March and April, Thailand’s private consumption\textsuperscript{30} decreased from 2013 to 2014 (WDI, 2015). With consumers spending less, even leading Thai companies—such as CP Group and shopping-mall specialist, Central Group—are considering overseas expansion.

However, despite these concerns, political instability in Thailand has thus far had minimal effect on economic growth. This is because most political parties are pro-business. Thus, no matter the political outcome, Thailand’s political conflicts seldom affect the business world. This conclusion is drawn from observing the relationship between political instability and economic growth in Thailand from 1960 to the present.

\begin{figure}[h]
\centering
\includegraphics[width=\textwidth]{political-instability-economic-growth.png}
\caption{Political instability and economic growth in Thailand. Source: GDP data from Thailand's NESDB.}
\end{figure}

\textsuperscript{30} Household final consumption expenditure (formerly private consumption) refers to the market value of all goods and services, including durable products (such as cars, furniture and home computers) purchased by households. (Gooding, 2011)
Figure 5.33 indicates that Thailand’s economic growth has withstood a series of coups, attempted coups and major protests throughout the decades. Indeed, the country’s critical downturns appear to coincide with the two major crises (the 1997 AFC and 2008 GFC) and natural disaster (2010 major flood), rather than any political event. Thus, political unrest in Thailand seems to have less effect on growth than do global events; however, further empirical testing is needed to confirm this.

In summary, although Thailand’s political flux has not hindered business growth in a significant manner, the weak political outlook remains the country’s Achilles’ heel, and is constantly exacerbated by the deep-rooted socio-political divide between the influential elite class and larger lower-middle class. These conflicts prevent the government from ensuring complete participation and general approval. In the globalisation context, the private sector is preparing for international movements, such as the AEC, yet the authorities lack the direction and competency to fully protect the national interest.

These issues highlight certain limitations to Thailand’s future development that should not be disregarded by policymakers. Based on this study’s quantitative findings, the following chapter discusses the political economy aspect of FDI and development, which is suited for study via qualitative factors that may be difficult to incorporate into an econometric model.
Chapter 6: Recommendations for Thailand’s Future

Direction of FDI

6.1 Introduction

This chapter proposes an analytical framework of the effects of FDI on development, under the political economy approach. The analysis will be case-specific and based primarily on a qualitative assessment of Thailand’s political setting and government policies, and their implications for FDI and development.

Thus far this study has indicated that, despite its criticisms, FDI has significantly increased during the past three decades. In fact, FDI may have grown faster than international trade because businesses tend to avoid protectionist pressures, and FDI offers great leeway to penetrate trade barriers. As a result, the world economy has witnessed a new vision of firms who now perceive the entire world as their market, which has led to dramatic political and economic changes in many areas of the world.

Past FDI literature has mostly concentrated on economic aspects of this phenomenon, driven by increasing fiscal competition among governments to attract FDI, which has diverted attention from the important political determinants of FDI inflows. In Thailand, recent political upheaval and falling international competitiveness suggest that political factors have considerable influence on economic decisions, and that the activities of the RTG affect economic performance. To understand the sources of Thailand’s internal conflict, this chapter discusses the recent political events that have extensively affected Thailand’s financial and business sectors, and distorted the economy. Ultimately, this will enable correct identification of the country’s underlying structural weaknesses, and critical analysis of the government’s FDI policy and the institutional effects of FDI.

In terms of its economy, Thailand had adopted colonial policies, despite never having been colonised. Gradual penetration of Western influence prior to the post-war
period was accepted after the country took a more liberal approach to international trade. However, in terms of politics, Thailand restrained from liberal ideology in its political system. Thus, this chapter begins with a brief overview of Thailand’s historical and political background, influenced by royal rule and a dictated political system. It aims to take a broad look at the context of Thailand’s economic transformation, focusing on the development of its political economy and the machinations of the political system. This chapter then considers recent political conflicts and the role of the current government, past economic performance and current trends, and FDI policy and its implications. The final section introduces issues related to structural weaknesses that may hinder the economy from moving into its next stage of development, and limit its competitiveness in the global market.

Specifically, this analysis draws together the different, yet related, aspects of the economy and sheds light on the relationship between FDI and economic development. The questions it aims to answer are:

- Which government policies are most beneficial to MNE operations?
- Which political institutions and market-friendly policies generate positive spillover effects and contribute most to the country’s long-term growth and development?

The political discussion and recommendations will be limited to what is deemed appropriate and relevant to the scope of this study.

### 6.2 Thailand’s Historical Background

Thailand began practising constitutional monarchy after the bloodless coup and Siamese revolution in 1932. The present head of state, His Majesty Bhumibol Adulyadej, is a ninth-generation King and Commander of the Armed Forces, whose executive power is exercised by the parliamentary government, led by military dictators
and ex-military officers. The political situation in Thailand is characterised by the chronic state of coups, frequent change of leaders and strong military involvement in government decision-making processes. Thailand’s turbulent series of successful and attempted coups are depicted in the following figure.

![Figure 6.1. Coups and attempted coups in Thailand. Source: Agence France Presse (2015).](image)

Since the establishment of the constitution in 1932, Thailand has experienced a total of 18 coups, six of which failed, and 12 of which succeeded. Viewing this repeated pattern, it is apparent that coups have become common in Thailand, rendering political instability an integral part of its history, where deep divisions in society persist to date.

### 6.3 Thailand’s Political Background

The idealist goal of democratic rule in Thailand has never been achieved as a result of many complications. People embrace different ideas of what constitutes democratic rule, political participation, legitimacy, party politics, rule of law and other key governances. From the beginning, Western definitions were inconsistent with local
ones. While liberal democracy seems suitable for modern governance, there is nothing pure and universal about democracy as a global ideology. Democratic political development in Thailand is a messy process, with gains and losses, dead ends, side-tracks, and the occasional fleeting victory. Due to its tendency to evolve over time, there is no fixed structure of democracy; rather, it is defined by both space and time. In this view, country-specific experience and context may be more significant in defining democracy. Over time, political tastes and opinions affect a broad spectrum of social and political values that ultimately support and tolerate new forms of political life. For example, the use of military force to overthrow and replace governments became a ‘legitimate’ aspect of the Thai political process, beginning with the 1932 coup. Lack of rule and regulation and weak enforcement of legal process is accepted, while protests and rallies have become the norm, and are expected to arise whenever the public is discontent with the government. This is because the Thai democratic rationale has been flawed from its inception.

Based on this, this study argues that Thai people’s perceptions of the representation and prerogatives of political leaders are different to the Western ideology. Thai democracy gained importance during PM Sarit Thanarat’s regime in the 1950s, marked as the most repressive and authoritarian regime in modern Thai history. However, although Sarit abrogated the constitution, dissolved parliament and vested all power in his newly-formed Revolutionary Party, he still contributed greatly to Thailand’s economic development by creating the NESDB—formerly known as National Economic Board—in 1950. This establishment played a crucial role in Thailand’s economic development as a key agency on planning and formulating of development strategies. As PM, Sarit based Thailand’s development plan on balanced and sustainable development, public participation, and flexibility in meeting the
changing environment and needs of the Thai people. Additionally, market competition and private investment were introduced as part of a plan designed by the US and World Bank. In later years, the NESDB formulated national plans with a five-year timeframe, with the key agendas of alleviating poverty and income distribution problems, enhancing Thailand’s competitiveness, promoting social capital development, and promoting sustainable development. Other functions included formulating strategies for key government policies and major development projects, analysing budget proposals by state enterprises and related agencies, creating an economic intelligence database (especially for GDP data) and developing development indicators. While some objectives—such as improving the economic database—are still far from successful, Sarit was at least able to promote a new economic concept to the Thai people and make them aware of the national ‘Phatthana’ (‘development’) plans. This important feature of the regime was largely influenced by an economic development model presented by the World Bank that pursued privatisation, industrialisation and commercialisation of the agricultural sector.

While the Sarit regime laid the foundation for Thailand’s industrialisation development and economic prosperity, it also created a distinct class discrepancy. This development plan did not help the poor or the rural sector because they became the fuel used to fire the engines of rapid economic development that benefited the urban sector and capitalist class. Consequently, this placed much pressure on the lower class. Since that time, tensions created by resentment of the remnants of this bureaucratic policy and liberal forces against rural (and perhaps less educated) politicians intensified and affected Thai politics. At the end of the Indochina War in 1954, there was an increasing inflow of FDI, which significantly improved Thailand’s infrastructure and social development. However, most of the economic activities took place in Bangkok and
surrounding areas. The benefits of these activities were largely enjoyed by the middle classes—which comprises only 10 per cent of the population—leaving the majority of the population in rural areas in destitution.

The public’s dissatisfaction was suppressed under adamant military rule until the 1970s, when several forces began to disturb the economy. As the Six-Day War broke out in the Middle East, the global market was shaken by the first oil shock. At the same time, Thailand was experiencing a change in its political regime. A massive demonstration from the general public ended the military government in 1973. This outbreak of political freedom in Thailand was synchronised with the triumph of Communists in Thailand’s Indochina neighbours at the time, which created fear of a domino effect, and Thai people dreaded the same fate for their country. Fear of the Communism movement eventually led to a violent confrontation that was ruthlessly terminated by a right-wing military takeover in 1976. However, the seed of political awareness from this 1973 uprising permanently altered Thailand’s economic and political space. The ensuing governments were no longer able to completely ignore the needs of the people, as reflected by an increase in government spending on public utilities and general service. However, one of the consequences of this development was a sharp increase in government budget deficit, which arose from the increased government expenditure, and eventually led to the persisting public debt problem for Thailand.

Thus far, Thailand’s system of rule has alternated between unstable civilian governments and military takeover intermissions. Despite its pledge to democracy, the middle class in the cities ignores the poor in rural areas, while the media are often bribed to present the preferred coverage. Corrupt officials and politicians are the norm of business practice, which then leads the military to take over control once corruption
become unmanageable or too obvious to the public. This gives the military an excuse to stage a coup, after which the regime hands the government back to elected officials. As a result, there have been 18 coups and 19 resultant constitutions in the record of Thai politics. Not only have these coups exposed a deep division in Thai society, but they also reflect the struggle for power between public servants and civilian politicians. Continued military control of the state dominates political decision making because the party system has neither institutional backing nor any real mass support. A stable democracy that requires real commitment to democratic procedures, a strong institutionalised party system and active pressure groups has not correctly developed in Thailand. The main political challenge is corruption and violent protests between political groups, which widen the urban–rural divide. As a result, the conflict between democracy and military rule continues to disrupt Thailand’s political system. In order to defuse this tension, the government needs to find a way to improve its transparency and accountability, which no leaderships have achieved since the Thaksin regime.

6.3.1 Political conflict. The significant role of the Thai military has reduced since the early 1980s. The emergence of new interest groups—such as business associations, non-governmental organisations, and farmers’ groups—combined with increasing congress power gradually lifted the legacy of military dictatorship. During the 1990s, Thailand developed some of the preconditions for democracy (pluralism, open politics and rapid industrialisation) and, while these changes did not completely end authoritarian rule, the military faced rising competition for state control from politicians thereafter. Today, a ‘guardian’ role is still advocated by the military, but with less public support as in the past. These features of Thailand’s political system have always existed, but regained attention since Thaksin’s regime.
Prior to the Cold War and period of US domination, the development model adopted by many Latin American and non-communist Asian countries (including Thailand) emulated that of Japan, Korea and Taiwan in the 1950 to 1980s. The economic foundation of this model included industrialisation, the rise of national capitalism, a new metropolitan class, a rising middle class, disappearance of serfdom, and a trend towards democratisation led by the managerial class. During this time, neopopulist politics appeared in a subset of developing countries, where it appealed to the disorganised masses, such as peasants and people in the urban informal sector, as evident in Thailand. A 2004 Labour Force survey indicated that the ‘disorganised mass’ of post-peasants and the urban informal sector amounted to two thirds of Thailand’s social structure, increasing the potential political influence of this large disorganised mass as the representative institutions become more established.

In contrast, many Thai technocrats have argued that ordinary people are somehow not ready for democracy because their involvement in politics is generally restricted. Given that people’s voices are often suppressed by hegemonic discourse and constitutional arrangements, they may not share political interests in a party or any form of lobbying. However, the rural and informal population who are non-active participants in democratic politics can be responsive to political goods, and thereby unwittingly become involved in political schemes.

6.3.2 Thaksin government (2001-2006). The subject of democracy has become the central controversy in Thailand’s political economy. During the past decade, countless street protests of anti-government groups have all been colour-coded or masked, whether upfront or in disguise, but all in the name of democracy. On one side is the pro-democracy group led by the exiled PM, Thaksin Shinawatra, and on the other side is the Democrat Party led by the succeeding PM, Abhisit Vejjajiva. Whether by
accident or design, all have contributed to socio-political tension, characterised by hostility and distrust, and driven by politicians’ battle for power.

Before proceeding further, it is important to acknowledge the sensitivity of monarchy and political issues in Thailand. This section will carefully determine the events surrounding Thaksin’s era, from the Yellow/Red Shirt outset to the military coups that led to much political unrest, which has since kept Thailand in ongoing turmoil. After winning a landslide victory in the elections of 2001, Thaksin—a business tycoon turned politician—introduced a range of policies to alleviate rural poverty, which proved highly popular. In terms of foreign policy, Thaksin abandoned his former nationalistic stance and reiterated his commitment to a liberal economy, with foreign investment promotion. Despite the growing dependence on MNEs’ exports, Thaksin asserted his neoliberal plan based on feasibility, and promoted further MNE investment in export manufacturing for the sake of faster economic growth. Although he failed to reverse any of the IMF-imposed reforms as he turned to neoliberalism, he implemented some small, yet significant, internal reforms, including the 30 baht health service, advances in education, subsidies for small farmers and low-interest village loans. These populist measures greatly benefited Thailand’s impoverished rural masses, and won Thaksin another election in 2005, with the highest voter turnout in Thai history. However, his power ended in September 2006 after he was accused of tax evasion, corruption, human rights abuses and more.

Thaksin’s expulsion in a 2006 army coup revealed a deeper socio-political conflict in Thailand. On one side were Thailand’s urban upper and middle classes, who were faithful royalists. They formed a ‘Yellow Shirt’ group led by the Democrat Party, who wanted to end the Shinawatra family’s grip on power. On the other side were the

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31 This thesis is not designed in favour of a political party or cross any boundaries. The aim is to highlight political events and identify the underlying causes of Thailand’s problems, which is necessary to make suitable recommendations later in this paper.
massive number of rural poor, who supported Thaksin because his development policies contributed much to their quality of life—from electricity to free healthcare—and significantly improved their overall living standards. This group consisted of peasants, labourers, youth, and the poor or lower class of Thai society. They became known as the ‘Red Shirt’ movement, who demanded to see Thaksin back in office to continue his development plans. These protests were intensified by resentment for the wealthy urban ruling elite who dominated, exploited and oppressed the poor.

Many Western academics seem to struggle to comprehend the reasons for this pro-democracy movement, and question why the Red Shirts chose to risk their lives for the cause of an exiled billionaire tycoon. Lack of understanding led them to characterise the movement as ‘fascist’. However, a potentially more truthful account of the movement is that the pro-democracy group was fighting for fundamental change in the society, rather than supporting one ambitious politician over another. Driven by poverty, hunger and unemployment, the exploited farmers voiced deep-seated grievances against both the Abhisit government and the fundamentally unjust society. From a political economy perspective, since the masses have been set in motion, the determination and militancy of the protestors has grown into a ‘class struggle’ between the wealthy and poor. People began to relate political injustice to social injustice, and infused a real desire for radical change in society that goes beyond the mere change of PM.

6.3.3 Abhisit government (2008-2011). Between 2006 and 2008, there were several political tugs of war, during which the Yellow Shirts and Red Shirts took turns in remonstrating the government. In their support of the Democrat Party, the Yellow Shirts boycotted elections in which Thaksin was likely to win again. However, this annulment of the election failed to keep Thaksin’s supporters out of power, which provided an excuse for monarchist reactionary groups and a subsequent military coup.
In 2008, a new government was installed, and Abhisit Vejjajiva—the leader of the opposition Democrat Party—was appointed PM. Even though his seizure of power was the negation of democracy, it was conveniently ignored by the West. Abhisit advocated for stronger anti-corruption measures to strengthen his position against the former PM Thaksin Shinawatra, who was accused of being the biggest corrupter of Thailand history. However, ironically, members of Abhisit’s cabinet were forced to resign due to corruption scandals, and Abhisit’s economic stimulus packages were criticised for alleged corruption. According to the critics who considered the request for a new election to be an acceptable elementary democratic demand, the Abhisit government represented the ruling oligarchy, reactionary Thai monarchy and military. However, this appeared to offer enough assurance for foreigners to invest in Thailand.

Abhisit faced major protests in 2009 and 2010, driven by clashes between Bangkok’s elite and the mass general public. The subsequent military crackdowns on protestors, which caused more than 90 deaths in 2010, became one of the most dramatic events in Thai history, highlighting the weakness of the regime and force of the mass movement. This tragedy resulted in Abhisit’s formal charge of murder, which to his reluctant stand down in 2011. He was succeeded by Yingluck Shinawatra in the election that followed.

6.3.4 Yingluck government (2011-2014). Yingluck Shinawatra, Thailand’s twenty-eighth PM, appeared as the softer version of her elder brother, Thaksin, who was ousted by the military in the 2006 coup. Despite her landslide election victory, Yingluck’s position quickly became uncertain amidst backlash against her weak populist economic policies and a bout of in-fighting among its inner circle. As her government lost its direction, the opposition waited for one faulty move in order to trigger another bout of unrest. The opposition’s machination succeeded in depriving
Yingluck of the means of progressing to achieve her policy goals. Yingluck’s push for a controversial amnesty bill for crimes related to previous political unrest ignited a major political outbreak in Bangkok. Thousands of people rallied against Yingluck’s attempt to clear the way for the return of her brother, Thaksin, who had been living in self-imposed exile since 2008. Her hasty measure undermined her own government and triggered a mass protest, led by Suthep Thaugsuban—a former Thai deputy PM who resigned from the opposition Democrat Party to lead the rallies. Believing that Thaksin remained a divisive figure in Thailand, the protestors surrounded and occupied government buildings in an attempt to disrupt the government and force Yingluck to step down so that they could abolish the ‘political machine of Thaksin’ and establish an independent ‘people’s council’ to determine the country’s leaders.

The damage caused by the amnesty bill was greater than Yingluck anticipated, and it became clear that Suthep’s real objective was to overthrow the Yingluck administration. Even after the amnesty bill was withdrawn, Suthep continued to provoke the crowd, and the anti-government demonstrations escalated under his guidance. Encouraged by the outraged groups of businesses, universities and civil organisations, Suthep vowed to revamp the Democrat Party with new leadership, new policy ideas and renewed commitment to parliamentary democracy. His civilian uprising was strengthened by the anti-amnesty group, while Thaksin’s chance of returning to Thailand became slimmer than before. As the amnesty gambit backfired and destabilised the Yingluck government, the two fifths of the voting electorate who had lost successive elections to Thaksin’s parties viewed this as an opportunity to once again overthrow the government. This returned Thailand to its vicious political cycle.

Thailand seems stuck on a merry-go-round of political conflict, replaying chaotic episodes from the last round of Yellow Shirt protests in 2008, when
demonstrators believed that the former PM Thaksin elevated corruption, and now to the new heights; that he continues to control the country through his sister Yingluck, held on to ‘democracy’ as a shield from the opposition’s attacks. Yingluck’s earlier refusal to step down was based on the argument that it was not the “Thaksin regime”, but a democratically elected government, which was a phrase emphasised in every interview. As the protests escalated, several countries issued travel warnings for Thailand, which affected the business and tourism sectors, which suffered a substantial fall under this prolonged unrest. After many weeks of demonstrations, Yingluck’s decision to dissolve the lower house and hold a general election failed to satisfy leaders of the anti-government protest, who insisted she resign from her position as head of government. Ironically, the anti-government protestors demanded a more absolute and ‘perfect’ democracy that would not involve elections. This caused great controversy among academics, politicians and policymakers, as political battles became a larger priority than upholding democracy. Strangely enough, with no valid explanation, the failure of democracy was also blamed on Thaksin for undermining the system.

During this time, the immediate effects were clear in the disruption to disbursement of government fiscal spending, decrease in tourism and halted foreign investment. After PM Yingluck dissolved parliament, the interim government was restricted in their spending and borrowing powers, which resulted in delays to much-needed infrastructure work, such as the government’s planned spending of US$67 billion on a high-speed train project and other infrastructure investments. Further, the political impasse became a major concern for many foreign investors, leading them to postpone most of their expansion plans and land purchases in Thailand. While devastating anti-government protests in 2008 and 2010 paralysed part of Bangkok and affected the tourism industry, they were relatively short-lived compared to the most
recent one in 2013. Many MNEs have started to diversify their investments to other ASEAN countries in order to minimise their risks.

6.3.5 Prayuth government. Endorsed by the monarchy, coups d'etat have repeatedly overthrown elected governments and claimed legitimacy in Thailand’s political process, including the most recent ‘denied coup’ in May 2014, which seized power from the caretaker government while awaiting re-election. Strongly backed by the old establishment and royalist Democrats, the military appears to be the most powerful force in Thailand’s political life. With this support, General Prayuth Chan-o-cha became Thailand’s twenty-ninth PM and twelfth military leader to hold the post. During this time, martial law\textsuperscript{32} was declared, political gatherings were banned, the media was strictly controlled, and the preceding constitution was repealed and replaced with an interim constitution that granted the National Council for Peace and Order amnesty and prevailing power to govern the country. This attracted much negative attention from the international media, with developed nations highly critical of such backward political measures. Portrayed as a hubris army show run by a double-speaking dictator, Thailand’s self-appointed junta government receives much criticism in its attempts to restore order. The general public experienced disfranchisement during the last five elections, after each elected government was aborted before completing their terms. Thus, the public view junta intervention as oppressive and undemocratic, while other critics perceive the return to military rule as the last effort of the privileged class to preserve the old order.

\textsuperscript{32} Martial law was declared in Thailand on 20 May 2014. This gives the military the power to take action against war or riots; use arms to suppress unrest; censor information; block and control postal services; enter and search any premises; establish national curfews; arrest any suspicious people and imprison them for up to seven days; and prohibit public gatherings, publications, broadcasting, transport, communication, travel, the movement of people, or any action that disrespects the Defence Ministry.
In terms of economic performance during this decade of political turmoil, Thailand’s record in improving the country’s standard of living has been unimpressive, especially compared to other Asian countries (see Figure 6.2).

**Figure 6.2.** Gross national income per person, in thousands of US dollars. Source: The Economist (2014).

Figure 6.2 shows that Thailand’s economic performance in the past decade, as measured by gross national income per person, has been mediocre compared to its regional peers in terms of changes in growth, between 1996 and 2013. The possible causes for this sluggish performance include the ‘middle-income trap’ phenomenon, ageing population, weak education system, widespread income inequality and the ongoing political impasse.

Following the army takeover in May 2014, some parts of the economy have recovered, while others remain lethargic, which suggests that ending the short-term political uncertainty was insufficient to completely return consumer and investor
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confidence. The coup has not resolved the divide in the country’s politics; thus, any change of power could see Thailand slide back into another crisis and even deeper recession. Thailand’s economic development is undermined by political tension, and the risk of a worse outcome is increasing, with no significant improvement in the political climate. Further, while the Thai people do not outwardly express their views for fear of imprisonment, the democracy is highly questioned and the future of the monarchy is doubted, especially in the eyes of foreigners. From the Western perspective, a true democracy is not possible without overthrowing the oligarchy; however, this is not possible in the presence of Thai monarchy. Even though the International Marxist Tendency expressed its firm support for the revolutionary movement of the Thai masses based on every democratic right, there will be no revolution in Thailand as long as the king remains a rallying point for all the forces of reaction. Thus, the class struggle will continue to have profound consequences amidst meaningless negotiations. Regardless of which government emerges from the current political disorder, it is expected to be inherently unstable because, as long as no lasting settlement is reached, new upheavals are inevitable. This is evidenced by the continuous demonstrations in the years to date.

Settlement is difficult to attain if the Thai people cannot even agree on the concept of ‘democracy’, which is often warped by politicians to suit their interests and protect their political positions. A fundamental problem in the Thai political system is that most of the money is in Bangkok, and most of the votes are outside Bangkok. Unless the two major factions in Thai politics—the Bangkok elite and rural majority—learn from the recent violence and moderate their behaviour to compromise on how to distribute power, then political instability and violence will likely reoccur. This indicates the substantial effect of the present global crisis of capitalism on Thailand, and proves that the ideas of revolutionary Marxist fixed to solve the needs of the working
people will not only cause the breakdown of Thailand’s present regime, but also the capitalism itself.

Finally, the lessons learnt from the country’s ongoing conflict and recurring military coups indicate that elections are not Thailand’s panacea. The recent show of strength on Bangkok’s streets by anti-government demonstrators determined to eliminate the ‘Thaksin regime’ evidences that elections will not resolve Thailand’s bitter political conflict. It is often argued that majority rule must accommodate more minority grievances. The lack of personal integrity of Thai politicians and poor lawmaking standards remain as large an obstacle as the corruption seen during the Thaksin years. The rules and restraints that are crucial for efficient bureaucracy are obvious weaknesses. Thailand needs an open judiciary, institutional checks and balances through the separation of powers, and independent observers that can effectively restrain capricious state action and corruption. As long as the main checks-and-balance institutions—such as the Constitutional Court and Anti-Corruption Commission—cannot completely detach themselves from political affairs, it will remain a struggle to identify any positive outcomes eventuating from Thailand’s so-called ‘revolution’. All these issues highlight Thailand’s fragile conditions, which further aggravate internal political divisions among the Thai people and deepen the structural weaknesses that will be discussed later in this chapter.

6.4 Government FDI Policies

Although FDI incentives have been actively promoted by both developed and developing countries worldwide, research on the relationships and interplay between foreign firms and host governments warrants further attention. Continuous adjustments to host governments’ policies, rules and regulations on international investment are necessary, particularly in this globalised era, in order to respond to foreign firms’ needs
and the rapid changing global environment. In recognising this, the Thai government has sought to support foreign firms through, for example, industrial and trade policies. This section discusses Thailand’s current FDI policies, evaluates these policies’ effectiveness, and suggests supplementary policies that may help generate a sound and favourable investment environment for existing MNEs and future potential international firms.

While the aggregate economic benefits of FDI are well established and accepted among scholars, critics argue that these benefits also incur substantial costs for the government and its people. In attracting FDI, the government is often pressured to provide a climate that is more hospitable to MNEs, thereby potentially shifting the focus from its domestic economic policy. Moreover, the state sovereignty and its real capacity for democratic governance may be challenged. In designing policies and recommendations to strengthen a country’s position in the global market, approaches should differ depending on the countries’ level of development and corresponding level of participation in regional production networks. This implies that most suitable approaches for Thailand may be different to those of lesser developing countries, such as Cambodia, Myanmar and Laos PDR, or more competitive countries, such as Indonesia, the Philippines, Malaysia and Singapore. The remainder of this chapter examines the overall effects of FDI and related policies at the macro level, as well as the promotion activities at the micro level, during the past 20 years in order to synthesise and provide key lessons from the Thai experience on using FDI as a tool of economic development under the constraint of its political economy framework. First, this section provides an overview of Thailand’s past FDI structure in comparison to other Asian economies, as shown in Figure 6.3.
### 6.4.1 Approaches to FDI liberalisation: Comparison of developing countries.

<table>
<thead>
<tr>
<th></th>
<th>PRC</th>
<th>India</th>
<th>Korea</th>
<th>Malaysia</th>
<th>Thailand</th>
<th>Viet Nam</th>
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<tbody>
<tr>
<td><strong>Ownership Structures</strong></td>
<td>Dominant but declining SOEs, rapidly rising private and foreign firms</td>
<td>Large SOE sector, reservations, schemes for small firms</td>
<td>Predominantly private, child labor important; high concentration; small SME presence</td>
<td>Always large foreign presence; active business promotion</td>
<td>Predominantly private; Sino-Thai dominance</td>
<td>Dominant SOEs, actually rising post reform</td>
</tr>
<tr>
<td><strong>FDI History</strong></td>
<td>Closed to 1978; rapid increase from 1980s, especially in south</td>
<td>Very restrictive pre-1991, then gradual opening</td>
<td>Restrictive until 1990s; then gradual opening; major 1998 reforms</td>
<td>Consistently open</td>
<td>Consistently fairly open</td>
<td>Closed to late 1980s; rapid rise from early 1990s</td>
</tr>
<tr>
<td><strong>FDI Presence</strong></td>
<td>Modest but rising</td>
<td>Modest, no clear trend</td>
<td>Low, rising gradually</td>
<td>Very high</td>
<td>Substantial, and rising</td>
<td>Low, but rising quickly</td>
</tr>
<tr>
<td><strong>Trade Regime</strong></td>
<td>Closed to 1978; then progressively opening, especially for exports, 2002 WTO accession</td>
<td>Very restrictive pre-1991, then gradual opening</td>
<td>From 1990s, open for export, otherwise restrictive; major 1990s reforms</td>
<td>Consistently open</td>
<td>Consistently fairly open</td>
<td>Closed to late 1980s; then major opening, especially for exports</td>
</tr>
<tr>
<td><strong>International Connections</strong></td>
<td>Hong Kong, China important, large diaspora</td>
<td>Large and active diaspora</td>
<td>Large US diaspora, reverse brain drain in 1990s</td>
<td>Singapore ties historically strong</td>
<td>No special features</td>
<td>Large diaspora, still regarded with suspicion</td>
</tr>
<tr>
<td><strong>FDI Regime in Practice</strong></td>
<td>Continuing through declining SOE performance; rapid decentralization; much corruption</td>
<td>Reforming, in context of disputes over the nature of state and state-MNC cooperation</td>
<td>Business climate becoming more predictable and open; powerful nationalist sentiment</td>
<td>Predictive</td>
<td>Reasonably predictable</td>
<td>Continuing SOE performance; north-south differences; private firm initiative</td>
</tr>
<tr>
<td><strong>Institutional Quality</strong></td>
<td>Uneven, though improving</td>
<td>Well-developed, though cumbersome</td>
<td>Generally high, though legal system still evolving</td>
<td>Generally high</td>
<td>Generally quite high; weak; very limited investor protection</td>
<td></td>
</tr>
<tr>
<td><strong>Human Capital</strong></td>
<td>Pockets of excellence; uneven, rapid catch-up</td>
<td>Pockets of excellence; continuing high literacy</td>
<td>Extremely strong education and R&amp;D base, though not very international</td>
<td>Generally quite good; major affirmative action program; continuing non-levy/partial brain drain</td>
<td>Historically under-invested in post-primary education; continuing non-levy/partial brain drain</td>
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**Figure 6.3.** Approaches to FDI liberalisation: Comparison of developing countries.


Compared to other developing Asian countries, Thailand has been relatively open to FDI since its liberalisation in the 1970s. It has had progressive development with no major swing in the policy pendulum. Prior to the 1997 AFC, Thailand was a major capital importer. While FDI increased to record levels, an increasing proportion of the flow was portfolio and other short-term capital. Virtually all restrictions on capital flows were removed in order to promote Bangkok as a regional capital market and catch up with better-performing countries, such as Hong Kong, China and Singapore. Even after the 1997 to 1998 capital flight and currency crisis, which led to a sharp decline in FDI in 1999 to 2000, the RTG held an open attitude towards FDI,
despite intense nationalist backlash, and regained its FDI flows in the following years (see Figure 6.4).

![Graph of Thailand net FDI inflows (BoP, current US$ million), 1993-2012](image)

*Figure 6.4. Thailand’s net FDI inflow, 1993–2013. Source: WDI (2013).*

While Thailand scored well on most indicators and appeared more active in FTA than did most countries in ASEAN, there was noticeable weakness in the case of human capital. Historically, Thailand’s education retention ratio has always been substandard, despite meeting the universal requirement of primary enrolments. As a result, Thailand has experienced difficulty in transitioning out of labour-intensive activities, even as the economy has progressively expanded its trade and FDI policies. Moreover, its legal and commercial institutions were historically weak, and physical infrastructure was generally good, yet inadequate when compared to the size of Bangkok’s overpopulated cluster. In particular, the needs of Southeast Asian economies lie mostly in transport, energy and communication. Despite the government’s infrastructure investment plan to develop railroads, roads, airports and others from 2015 to 2022—which proposes for the
government, state-run enterprises, public and private partnerships and other entities to invest a total of 2.4 trillion baht (around 18 per cent of the current GDP)—actual implementation has yet to be seen.

Another obvious disadvantage for Thailand is its weak ownership structure compared to other five countries. There are no economy-wide estimates and, even for manufacturing, the first reasonably comprehensive data became available in 1996. These data reported that firms with foreign shares produced around half of the country’s industrial output, and employed 41 per cent of the workforce. Three years later, no significant change was found in the immediate aftermath of the AFC. There have been different approaches to FDI among the six countries in relation to the speed of liberalisation, modalities of capital inflow, and particular benefits sought from these investments. Among the crisis-affected economies, the immediate challenge has been in financial reform and economic recovery. Vietnam has employed a strategy of re-engaging with the global economy in the context of ‘first-round’ economic reforms. Meanwhile, China is progressing more quickly, with earlier transition from a planned to market economy, and movement towards a unified policy regime. In contrast, India strives to be more ‘East Asian’ in its labour-intensive export path. Korea has sought to internationalise its human capital and R&D strengths, while Malaysia and Thailand face similar struggles in upgrading supply-side capabilities as they lose comparative advantage in labour-intensive activities.

Unsurprisingly, these countries have taken different approaches to formulating international regulations governing FDI. As with most developing countries, these six have liberalised their investment regimes, but with clearly widely diverging views on negotiating a multilateral framework for investment. Which outcome emerges will
depend on the bargaining positions adopted by different countries, and the attitudes they have towards the process. These attitudes range from:

- strongly in favour (Korea) to strongly opposed (India)
- viewing it as a helpful spur to domestic liberalisation (Thailand) to viewing it as a constraint on development policy options (Malaysia)
- acceptance if implementation is gradual (China) to concern over capability to address the difficulties and challenges of achieving compliance (Vietnam).

These economies differ considerably in terms of economic, political and cultural realities, and require a country-by-country analysis of the details of their FDI policies and development strategies. This went beyond the scope of this thesis, which primarily sought to examine the considerations relevant to the Thai political economy and FDI performance.

Traditionally, Thailand’s economic growth has been built on relatively low-tech industrial development that is dependent on a cheap and efficient workforce. After trade liberalisation from an IS to EP regime, vast inflow of FDI enabled Thailand to shift substantial resources from traditional agriculture to labour-intensive manufacturing. However, increasing competition from other Asian nations—particularly China, India, Indonesia, the Philippines and Vietnam—must not be underestimated. Not only do these countries possess more abundant resources and lower labour costs, but the stronger Thai baht and recent increase in minimum wage further weaken Thailand’s competitive position in labour-intensive exports. Further, comparatively slow technological progress is a major weakness in Thailand’s ability to move up the value-added chain and enhance its comparative advantages. Above all, the deteriorating situation of Thai political disorder is discouraging foreign investors, and redirecting them to safer investment locations. Global stakeholders make no secret of their concerns regarding Thailand’s
destabilising politics and corruption among influential politicians. They are also aware of the frequent occurrences of coups d'état and the lack of trust in politicians among Thai citizens, and thus remain watchful of the risk of further political unrest when another election arrives.

Against this backdrop, theories of FDI relevant to the case of Thailand are best analysed from a political economy perspective. This study uses conceptual frameworks developed from two major disciplines—international business and political economy. For institutional and historical analysis, a modified conceptual framework from the international business discipline can be used—the IDP developed by Dunning (1981). In her thesis, Santipitaksakul (2010) suggested that the Thai developmental path is taking the form of a capital-dependent state, which means that economic growth in Thailand is largely dependent on foreign capital and technology. If Thailand’s current investment promotion scheme appears to favour and benefit foreign investment more than domestic investment, the country requires policy revision towards FDI. Thailand will need to strengthen its national competitive advantage as the main determinant of FDI flows and key element of its FDI-promotion scheme. Only when this is achieved can the country build an attractive image that encourages investment from professional institutions, with necessary legal and political support.

6.4.2 Political influences. From a political economy perspective, the development of the Thai economy is dependent not only on prospects for growth and trade at the global and regional level, but also on the political influence on foreign investment. Political influence relates to the immobility of capital after foreign investment has been made, resulting in a shift of bargaining power from MNEs to the government. That is, while FDI is liquid ex ante, once it is committed to an investment location, it becomes more illiquid, which forces MNEs to carefully consider the future
policies of host governments. In Thailand, where it is not unusual for politicians to make false promises on future policies, or for governments to change policies once major deals have been settled, MNEs can be vulnerable to political play when investing in the country. Particularly given the unsupportive legal system, the RTG faces a difficult task in providing security to potential MNEs, who can devote substantial resources to its mega projects. To overcome this, it is advisable for the RTG to commit to a specific policy equilibrium that ensures higher stability and lower political risk for MNEs. Further, the RTG should continue to improve its market-friendly policies, which have proven reasonably effective in attracting FDI during the past decade.

Thus, this study argues that political influence on future policy is central to attracting FDI. This view is slightly different to past conventional wisdoms, such as the ‘race to the bottom’ thesis, which downplays the importance of political factors in affecting government policy. Such traditional views are based on the concept of high capital mobility, and ignore the complexity of investment decisions. While the ‘race to the bottom’ thesis overemphasises the importance of fiscal competition for FDI and downplays political influences, the current study elaborates on the relationship between political institutions and FDI inflows, with particular emphasis on Thailand’s democracy and political regimes.

6.4.3 Democratic institutions and FDI theory. As far as this study’s exhaustive review of the FDI literature discovered, the role of democratic political institutions has been largely underplayed due to the general perception that MNEs prefer to bargain with authoritarian leaders. Specifically, MNEs tend to invest in countries ruled by dictators who do not have to respond to an electorate, and thus have free rein over their negotiations with MNEs. This secures foreign investors with higher incentives in a more stable investment environment that they seek. However, to simply
conclude that foreign investors prefer autocratic regimes may be presumptuous when considering the effects of democracy on economic performance and international relations, as established in numerous studies. For example, Jensen (2003) empirically assessed the political preconditions for attracting FDI using both cross-sectional and panel regression analysis in 114 countries, and found that democratic political institutions attract as much as 70 per cent more FDI as a percentage of GDP than do their authoritarian counterparts.

These findings debunk some myths about political institutions’ effects on FDI. As academics debate the real benefits of the FDI liberalisation that the World Bank recommended for the developing world, the need to understand the effects of political influence on macroeconomic policies and performance is even more crucial. In terms of public policy, the IMF’s role on macroeconomic performance requires examining. Recent studies have analysed the effects of the IMF on long-term economic growth—for example, Jensen (2008) focused on the nature of IMF programs on long-term FDI inflows, and found that IMF programs lead to lower FDI inflows. The current study considers the links between political regimes and MNEs to be relatively understudied, and that there is a high possibility of democratic influence on FDI inflows for the following reasons.

First, democratic countries can attract MNEs through informative channels because democracy offers greater transparency, both in economic and political affairs. Thus, MNEs can obtain better information on government policy and current political and economic conditions, which is essential for their investment decision making. Second, under representative democracy, MNEs have more opportunities to pursue favourable policies through indirect participation in domestic politics, such as campaign contributions or other activities that influence politicians’ trade policy stance. More
directly, MNEs can lobby government officials for their preferred legislative outcomes. This is only possible in democracies—not autocracies. For example, a study by Hansen and Mitchell (2000) in the US found that lobbying activity was frequently conducted by both foreign firms and domestic firms. In contrast, authoritarian regimes may discourage overall FDI inflow as difficulty of influencing policy is unfavourable for MNEs. Lastly, democracy enhances the credibility of international trade agreements by creating incentives for governments to pursue policy changes that are favourable to MNEs, while placing a certain constraint on the government’s actions and reducing the risk of policy reversal. As democracy promotes transparency and participation, government officials’ and politicians’ actions are closely monitored by ‘veto players’, such as chambers of the legislature, the supreme court, separation of the executive and legislative branches of government, and federal actors. Democratic governments have these institutional constraints in place, making the possibility of policy reversal less likely. This creates an ‘audience cost’ that is associated with democratic governance.

Indeed, the political stance of MNEs in democratic states appears to be even more influential than that of domestic businesses because elected officials are threatened by MNEs withdrawing existing investments or refusing future investments in response to negative policy changes. Considering that democracy allows citizens to rightly replace disreputable leaders through electoral mechanisms, democratic leaders may lose electoral ground if held accountable for their actions. Therefore, under a democratic system, political leaders tend to avoid policies that hamper MNEs for fear of developing bad reputations and electoral backlash. Further, as large illiquid FDI projects tend to settle where there is a lower probability of policy reversal ex-post, it is argued that democratic governance makes international agreements more credible, and thus leads to higher FDI inflows. This view is supported by Cowhey (1993), Fearon (1994),
Gaubatz (1996), McGillivray and Smith (1998), Leeds (1999), Feng (2001) and Jensen (2003, 2006, 2008). It is consistent with the international political economy and international relations notion of democracy encouraging international cooperation (Mansfield et al., 2002; Martin, 2000; Milner & Kubota, 2005). A similar study in the area of international trade agreements also supported the argument that international institutions enable governments to make more credible commitments and facilitate MNEs (Simmons, 2000). Other studies emphasised the role of international institution in world politics by focusing on human rights enforcement, environmental policy and military conflict (Hafner-Burton, 2005; Limao, 2005; Mansfield & Pevehouse, 2000). Most results have shown that trade agreements can increase FDI.

Democracy in Thailand seems to be differently defined, and the long series of military coups and public protests suggest that Thai democracy is far from stable. There have been at least 23 military coups over the past 80 years of Thailand’s democratic regime. In particular, the 2006 coup that led to chaos in Bangkok was an important and unsettling event that illustrated a failure of the democratic approach that the US has always encouraged. Repeated episodes such as this highlight the problem of Thai democracy being weakened by endemic corruption, including blatant vote buying in rural areas. A comparison with Thaksin seems apt. Accused of corruption, buying rural votes and being a threat to the monarchy, the Bangkok elite removed Thaksin from power in 2006, thereby setting the stage for the political standoff that has lasted since. Among newly democratising nations, Thailand seemed to be the best prospect for stable democracy in the 1990s, attributed to a military government overthrow in 1992 and subsequent democratic movements, such as several free elections and the reformist constitution that ensured civil rights. However, this all changed after the 2006 military coup that overthrew Thaksin and led to series of violent battles between the Red and
Yellow Shirts. Thailand’s story became an example of how democracy can fail, as the country reverted to a type of soft authoritarianism, where the military plays an enormous role in determining politics. It has recently become evident that the Thai middle class has turned anti-democratic, and the Freedom House (2013) subsequently ranked Thailand as only ‘partly free’. As such, the country has plunged to being near the bottom of all developing nations in rankings of press freedom (Freedom House, 2013).

Prior to the 2006 political outbreak, most of the RTG’s attention was focused on the AEC, which not only aims to waive duties and reduce tariffs—as evident from other FTAs—but also to integrate the markets of ASEAN into a single production and consumption base. By deepening economic integration among these countries, it is anticipated that the AEC will attract additional inwards investment from both international and domestic investors from inside and outside ASEAN (Assunção, Forte & Teixeira, 2011). As such, the Thailand government expects a notable increase in the number of foreign investors due to its advantages in existing infrastructure, proximity to China and positioning at the centre of the AEC. However, the reality may be very different, considering Thailand’s current political impasse.

The effect of this political unrest is mostly evident for FDI. For example, investments from Japan experienced a decline from US$328 million in 2012 to US$47.5 million in 2013. Although the country saw some increases in its main exports and imports, such as rice and garments, the attractiveness of Thailand for FDI is clearly reduced, with foreign investors reducing their stock and bond exposure and drawing away from major new projects involving FDI. Foreign investors have lost confidence while witnessing the gradual breakdown of Thailand’s previously sound macroeconomic environment, in which immobilised government ministries are unable to implement any effective long-term economic policies. Political tensions affect
tourism and dampen domestic consumption in the short term, and adversely affect investment decisions through delayed infrastructure projects and a lower credit rating in the long term. Importantly, Thailand’s current political crisis has appeared to delay the forming of a new government, which will inevitably delay the approval of the government budget and create both financial and real losses in terms of investments and jobs. This observation is supported by a recent study by Jensen (2008), which empirically tested the effects of political institution on economic policies and hence FDI. It asserted that political institution can provide MNEs with credible commitment to stable economic policies that can enhance their operations and the domestic market. Thus, institutions affect policies, and policies affect multinational operations. Analysed in a dynamic context, political institutions that make intertemporal commitments to policy stability, while retaining the necessary flexibility to foster an environment MNEs desire, will attract higher levels of FDI.

6.4.4 Thailand’s political impasse. An article by Hanvongse (2013) provided interesting insight to Thailand’s current political conflict, which has become intractable and dragged on for almost a decade, with no end in sight. In trying to understand the core problems, analysts have adopted different frameworks to explain the situation and have considered many factors—such as power, legal and institutional stability; social justice; the social psychology of human interaction; covert processes and hidden agendas; the social construction of reality and collective identity transformation; and the system theory. The flawed nature of people is highlighted, with the elite group claiming to be righteously fighting corruption and calling for protection against the tyranny of the majority, while the mass rural populaces are fighting for social justice and calling for democracy. The suppressed mass of the lower class seeks inclusion, equality and a voice in the electoral process. From their perspectives, the varied forms of ‘isms’—
particularly classism—are the root causes of Thailand’s political conflicts. They demand income redistribution, economic development, human rights education, educational reform and various forms of integrative power sharing (Hanvongse, 2013).

Previous studies have demonstrated that different forms of political dissatisfaction are the cause of the current conflict. In particular, systems theory serves as a super-ordinate framework for all approaches by viewing the conflict as a whole system, and shifting the focus from individual roles to a much broader pattern of societal behaviour. From a systems perspective, the votes of people around the country should not be discounted because of the independent, unlawful actions of the members of parliament for whom they voted. Further, ending corruption by removing an elected government can subject the nation to a political vacuum and leave it open for other forms of corruption to take place. Thus, removing the corrupt elements from the system needs more than a protest marathon with no real feasible revolutionary plan—otherwise the nation will attract the type of corruption it is trying to remove. It is not a promising situation for the system as a whole when electoral legitimacy is pitted against judicial legitimacy. From this perspective, the conflict is rooted in a disorganised system that requires a multi-level, long-term intervention. Intractable disputes are based on different mental frameworks that are intermingled in the same discourse. To ease the current political tension, all parties involved must first understand the origins behind people’s reasoning, and hope that there is sufficient collective wisdom in the country to find a workable solution once space is created for differing perspectives.

In essence, Thailand’s conflicts signify the increased social and political complexities that arise with prosperity and globalisation. The challenge for Thailand is to gain people’s cooperation, which it has failed to do in the past. A combination of closed-mindedness, self-righteous beliefs and lack of education has led to people being
misinformed and easily influenced by their chosen media. Proving that one was right and the other was wrong has become more important to them than finding a compromise or working out their differences. Negotiation has become impossible, while international conferences and intellectual discussions are seen as unnecessary interferences in internal conflict that only result in the government wasting tax money on organising such events. Scholars are discouraged because their analyses are either scorned or ignored. Foreign advisers are accused of meddling in Thai domestic affairs.

Ignorance and misunderstanding have caused Thai people to resent foreign presence and continuously gather into groups of protestors at many international summits. Thus, it appears that there is not only a conflict between the government and its opposition, but also a larger conflict between Thai people and outsiders, which fuels misunderstanding and mistrust in the midst of Thailand’s long-standing internal conflict.

One of the biggest challenges for Thai policymakers is to build trust and open discussions for participation by everyone in the country. During the past decade, the opposition has been unable to work effectively in the parliament, independent organisations were not truly independent and the mass media were unable to access information freely. Although the economy has maintained moderate positive growth since 1999, its future performance is very uncertain. While continuous reforms of the financial sector, corporate debt restructuring, attracting foreign investment and increasing exports remain high priorities, the challenge is not to return to the old path of economic growth, but to create a more stable political framework that abides by the law, emphasises human rights, allows people’s participation and encourages better functioning of the government to improve the concept of public service, development strategies and social values.

6.5 Underlying Structural Weaknesses
This section focuses on the most critical issue of Thailand’s underlying structural weaknesses, which should be a priority of the government when designing economic policies. While previous chapters have already discussed Thailand’s fundamental weaknesses in terms of human development, such as health and education under the SWOT analysis, this chapter incorporates study of political economy pertaining to international trade and finance, and their effects on the country’s development. It aims to present concrete proposals of how the government can adjust its policies and introduce reforms to solve the problems hindering the next stage of Thailand’s growth.

Although Thailand became closely integrated in global production chains after its liberalisation and enjoyed very high rates of growth, the fire-sale of Thai companies in the 1997 AFC empowered the foreign presence and accentuated its dominance, especially in the export industry. This has sent the economy down an unbalanced growth path that relies too much on the performances of major economies, such as the US and Japan. Almost all major manufacturing that was nurtured during the development era—particularly manufacturers that were export-oriented—passed into the hands of MNEs. Domestic capitalists who were initially successful from copying the industrialisation patterns of advanced economies were unable to prevail in competition with MNEs. Industrialisation via FDI is typically based on technology developed in advanced countries, and hence is more capital intensive than local conditions necessitate. Further, Thailand’s industrial labour force is relatively small, and subsequently weak in organisation. During this post-crisis time, the remaining peasants significantly outnumbered the organised working class, the middle class became externally focused, the informal sector expanded, and foreigners gained increasing dominance over Thailand’s industrialisation. In this light, the evolution of society and
social classes has differed greatly from what was predicted under the ‘development’ model due to many structural weaknesses created thereafter.

6.5.1 Development model. The above overview of Thailand’s development path indicates that Thailand has embraced globalisation through trade and investment liberalisation. Following a transition from an IS to EP regime, Thailand has openly pursued market-driven development policies for over 30 years. However, while liberalisation of FDI appears to be more beneficial than harmful to developing nations, the degree of ensuing economic growth and development vary depending on the accommodating environment and supporting policies. Thus, the result of an export-led growth strategy, especially in terms of FDI, needs to be assessed carefully. For Thailand, despite high average growth for the past 50 years, economic performance is far from being excellent, especially in comparison to Japan and other NIEs. This has been largely due to the difference in actions taken and policies implemented by governments, particularly with regard to foreign policies. As a result, from the 1970s to the present, East Asian nations have been exhibiting various degrees of economic development. Thailand’s lesser development reflects the ineffectiveness of the neoliberal development reforms that Thailand adopted as the model of its development.

Following the Washington Consensus, Thailand presents a unique case study under the hegemony of neoliberalism and management of inward FDI. Unlike other successful NIEs, Thailand's development path differs by its implementation of all the major orthodox development policies influenced by the World Bank and the IMF in the early days. While countries such as Japan and NIEs followed a dirigiste model, Thailand followed a neoliberal model of development. In the early 1970s, Thailand adopted EP policies in parallel to a FDI-led growth strategy, with no specific industry or sector promotion. While Japan was unfriendly towards inward FDI at an early stage,
Thailand has hardly used subsidies for her own domestic firms, or been unfriendly to international investors. In Thailand’s haste to liberalise, national firms became deprived of government subsidies, special privileges and necessary protection against international competitors. Nevertheless, FDI continued to gain an increasingly significant role in Thailand’s economic growth from the early 1980s onwards, following its trade liberalisation and fiscal discipline of the neoliberal ideology. This is reflected in the availability of FDI data, which can only be traced back to 1977.

A lesson to be learnt from more successful NIEs and Japan is these countries’ attitude towards FDI during the early stage of their economic development. Recognising their unprepared stage of internal development, Japan, Taiwan and South Korea were initially notably unfriendly towards inward FDI. Thus, rather than embracing a contemporary framework, they concentrated on building successful and strong domestic firms, supported by the state. These firms were heavily subsidised by the state in order to protect them from international competitors during their inception; thus, they were able to grow strongly and eventually became successful MNEs.

While Japan developed effective policies and necessary measures to protect its industries in a manner that best suited its economic setting, Thailand was confined to its pragmatic neoliberal ideology, and attempted to fit the economy to a contemporary development model. This limited government intervention and subsequently discouraged appropriate industrial planning. The contemporary model focuses mainly on poverty reduction; providing basic needs, such as education and healthcare; sustaining the existing productive structure; and ensuring individual betterment. This model appeared suitable for Thailand’s development needs; however, this can only be achieved with a strong foundation of internal productive capability. In contrast to Japan, Thailand seems to have failed to follow the correct sequence of development. As such,
it is placed in the rear position of the ‘flying geese’ pattern, which indicates Thailand’s slower development, especially in terms of technological progress, compared to other developing Asian countries. By implementing a contemporary model of development without prior industrial planning or necessary protection of its infant industries at an early stage, Thailand faced challenges in maximising its benefits from FDI.

Thailand made hasty decisions because it preferred the contemporary development strategies prompted by the IMF and World Bank, rather than precautionary economic counsel. Fuelled by the idea of liberalisation, Thailand embraced the introduction of foreign firms without realising that the superior presence of these firms can amplify market imperfections. Negative effects of FDI can arise, and it can be perilous to ignore these—particularly in Thailand’s case, where the contemporary development regime undermines the role of the state and effective industrial planning, thereby undermining sufficient and appropriate government interventions. This has had an unfavourable effect on economic development as foreign investors received greater benefits through the government’s investment incentive schemes, while domestic entrepreneurs found it difficult to develop their owner-specific advantages. Thus, the government’s desire to attract more FDI has undermined internal progress. Even though overall productivity growth has seemed reasonable, most of this growth was in agriculture or emanated from inter-industry shifts.

Econometric evidence in Thailand from Young (1994), Collins and Bosworth (1996), Tinakorn and Sussangkarn (1998), Rattso and Stokke (2003) and Diao et al. (2005) largely point to factors of productivity growth being learning by doing, technology adoption, foreign technology spillover and increased openness of the economy. While education and skill levels have improved somewhat in Thailand, the low-tech labour-intensive industries do not indicate that this is a major growth factor.
Rattso analysed foreign spillover and productivity sources in agriculture and industry for 1975 to 1996, and found that TFP growth in Thailand has mostly been driven by learning and imitation, while investment in national R&D has played a minor role. Similarly, Diao (2005) found that Thailand’s trade protection has concentrated more on industry than agriculture, when compared to the likes of Japan. He suggested that Thailand’s model weakens the industry and growth via protectionism in both the short and long term. Overall, past studies indicate that the lack of innovation in Thailand is the result of low R&D that can only be improved by advanced skills. The general conclusion is that the lack of government intervention, insufficient R&D, low subsidies and protection for domestic industry, combined with excessive FDI incentives and preferential treatment of MNEs, have led to superficial growth and inferior development in Thailand, in comparison to other Asian NIEs (Diao, 2005).

6.5.2 Dependency theory (capital-dependent state). Dependency theory is much more than just a school of academic writing. This theory has played an important role in the history of economic development by drawing together the intellectual association of Marxism and southern nationalism. In the book, Marxism in Southeast Asia: A Study of Four Countries, which outlines and assesses the effect of Marxism on the modern history of Burma, Thailand, Vietnam and Indonesia, Wilson (1959) asserted that Marxism has had demonstratively little influence on Thailand. He argued that a fortunate history and propitious environment have minimised Thailand’s pressures for change, and that successive governments have managed to overcome the political, economic and social hurdles resulting from Thailand’s entry into the modern world. Thus, while various Thai intellectuals have individually flirted with Marxism from time to time, its revolutionary message has largely gone unheeded because so few people have felt the need for revolution. It is not only external economic forces that dictate
Thailand’s dependent status, but also the sociological consequences of this power. According to most dependency theorists, the real force that jeopardises independent regimes comes not from an active threat of foreign intervention, but from the threat of withdrawal. This risk is accentuated in capital-dependent states, such as Thailand. This aligns with Marxism, which states that economic forces do not act alone in any sense, but must be considered sociologically as modes or relations of production creating specific patterns of political conflict over time.

From assessing the effect of FDI on growth under circumstances where the state is weak and power of foreign capital is strong, Santipitaksakul (2010) found that the effect of FDI on Thailand—whose market is shaped by neoliberal policies—is likely to be similar to that advocated by dependency theory. This alternative framework is supported by critics of FDI, and emphasises the nature of MNEs and their effect on market competition in host developing countries. This framework could prove more compatible with the recent economic environment in most developing countries under neoliberal dominance, such as Thailand. In fact, the RTG has implemented extensive investment policies since the country’s liberalisation, and offered generous FDI incentives in hopes of gaining a potential comparative advantage through significant investment. Given that governments can only supply a limited amount of investment, this inevitably leads to increasing dependency on foreign capital, which distorts the institutional structure of the economy. Thus, in pursuit of liberalisation, Thailand has developed economic features of being a ‘capital-dependent’ state, consistent with dependency theory.

Given that the RTG’s desired spillover effects are conditional on the availability of human capital, technological capacity, a liberal trade regime and financial market development, it is crucial that relevant government policies are implemented in the right
areas at the right time. Effective policies will empower the role of the state in regulating and controlling the direction of FDI to best serve the objective of the developing nation. However, after the AFC, Thai academics suspected a certain structural deficiency in the Thai economy, and called for reassessment of the effectiveness of the neoliberal development regime (Hewison, 1999, 2001, 2005; Pongpaichit & Baker, 2005, 2008; Santipitaksakul, 2010; Winichakul, 2008). There is general consensus that the lack of productive capability embodied in Thai domestic firms opened the way for MNEs to gain dominance in export sectors. The AFC highlighted the post-crisis structural changes in the economy, and rendered the country increasingly dependent on external factors. Given that national productive capability is responsible for sustainable development, it is interesting to investigate whether Thailand’s FDI-led growth policies and neoliberal development model can explain its structural weaknesses in some manner.

A study by Santipitaksakul (2010) expressed concerns about Thailand because the ability of the government to intervene in international investment is significantly limited by the country’s neoliberalism influences, which leads to continuous FDI regulation that prioritises foreign investment over domestic business. In her political analysis of FDI in Thailand, Santipitaksakul (2010) adopted the IDP framework to evaluate the dynamic role of FDI and its effect on economic growth. In this case, the international business framework was extended into the field of political economy, and applied to assess whether Thailand is following a path of complete capitalist development or dependent development. From the evaluation of FDI-related policies, the study found Thailand to be relatively weak in terms of industrial planning due to its neoliberalism pressures.
6.5.3 IDP framework. The IDP is an international business concept by Dunning (1981) that Santipitaksakul (2010) extended to the field of political economy to assess whether Thailand is following a complete capitalist development or dependent development, based on the Net Outward Investment (NOI) measurement. The IDP also indicates the ideal timing of when inward and outward FDI should be promoted along the path of development, and thereby sheds some light on the dynamic nature of FDI-related policies. IDP theory states that a country’s NOI position changes as it develops, with the level of development measured by GDP, and NOI measured by the difference of outward and inward investment stocks (Dunning & Narula, 1996). In this model, the NOI is the key indicator that reflects the OLI advantages that domestic firms possess relative to MNEs. The relationship between NOI and development identified in this framework is divided into five stages, as depicted in the following figure.

Figure 6.5. Five stages of IDP. Source: Dunning and Narula (1996).

The first stage of the IDP represents the pre-industrialisation period, in which the location advantage is weak and any FDI inflows are attributed to the country’s natural assets. FDI outflow is virtually non-existent at this stage, as domestic firms have not yet developed ownership advantages to enter the global market. The second stage witnesses higher FDI inflows and the first signs of development in outflow. In the third
stage, outward FDI gains momentum with stronger ownership advantages of local firms, while inward FDI decelerates, resulting in an overall increase in NOI, as depicted in the above figure. The fourth stage reflects equal inflow and outflow of FDI, where national firms are fully established in the global market as MNEs. The last stage corresponds to NOI that fluctuates around zero, with most FDI inflows market-seeking and/or knowledge-seeking in nature. Santipitaksakul (2010) described the IDP framework as:

the evolution of the international, direct investment position of a country across its path of development, that is, from the early stage of development where an income per capita is low to the later stage of development where the income per capita is high.

The IDP framework indicates that the second and third stages seem most relevant to Thailand’s present stage of development, where NOI is still negative and the economy operates on a significantly high amount of FDI inflows.
Table 6.1

Development of FDI and NOI in Five Stages of IDP

<table>
<thead>
<tr>
<th>Stage</th>
<th>Inward FDI</th>
<th>Outward FDI</th>
<th>NOI</th>
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</table>
| 1     | Insufficient location advantages  
- Minimal amount of inward FDI, natural resource-seeking only | Absence of local firms’ ownership advantage  
- No outward FDI | Fluctuates around zero and negative value |
| 2     | Development of ‘generic’ location advantages  
- Faster increase of inward FDI than of GDP  
- Mixture of resource-seeking, market-seeking and efficiency-seeking FDI | Realisation of local firms’ country-specific ownership advantages  
- Induction of outward FDI | Increase in negative NOI |
| 3     | Erosion of location advantages in labour-intensive activities  
Development of created-asset location advantages  
- Decreasing rate of inward FDI growth | Increasing ownership advantage  
- Increasing rate of outward FDI growth | Decrease in negative NOI |
| 4     | Location advantages entirely based on created assets  
- Superiority of outward FDI over inward FDI | Firm-specific ownership advantages more important than country-specific advantages | Positive NOI |
| 5     | Theoretically, fall and then fluctuation around zero of the NOI, but no longer a reliable relationship between a country’s international investment position and relative stage of development | | |


While this IDP framework depicts the relationship between FDI flows and a full path of economic development, it lacks the empirical component necessary to assess the full effect of FDI on economic development. Moreover, the factors influencing IDP have changed over time. With differences in countries’ economic structures and deeper MNE connections, the national boundaries of firms have blurred. Thus, MNEs’ firm-specific ownership advantages are no longer defined by their domestic settings, but are subject to changing host countries’ conditions, such as economic structure, investment environment and government policies. Thus, the nature of IDP has become
idiosyncratic, and is best analysed under a country-specific framework. Recent
development in the literature has reassessed the validity of the original framework, and
considered an alternative paradigm that better portrays the development path commonly
found in developing countries. In contrast to the original IDP framework, which only
highlights the positive effect of FDI, an alternative IDP framework outlines another
potential scenario in which FDI negatively affects economic growth. Shifting focus to
the political economy, the degree of government intervention plays a crucial role in
determining the fate of the economy—that is, whether the economy is led into the
difficult cycle of dependency, or the virtuous cycle of development.

In contrast to the stylised IDP model, in which the government successfully
implements development policies and a backward economy becomes fully
industrialised, the alternative IDP model takes into account the likelihood of increasing
capital dependency, which can lead to the development trap experienced in many
developing countries, including Thailand. Under this setting, the economy is
characterised by its overreliance on inward FDI, and government assistance for
domestic firms remains minimal. The failure of a country to effectively upgrade its
comparative and competitive advantages during its development path leads to the
middle-income trap, where the lack of productive capability and/or lack of ownership-
specific advantages in domestic firms expose them to superior foreign competition and
increasing FDI inflows. Figure 6.6 demonstrates the stylised relationship between the
NOI and the stages of development in capital-dependent developing countries.
Figure 6.6. Development path of a capital-dependent state. Source: Santipitaksakul (2010).

The above scenario depicts the role of the state that is typically found in developing countries where neoliberal development prevails. In this scenario, state interventions are redirected or suppressed in such a way that the government is unable to undertake the development policies exhibited in the first scenario. Instead, the economy is condemned to a different development path, where it is bound by the neoliberal ideology that deters complete development of national ownership-specific advantages relative to MNEs, even after participating in an international economy for a period of time. Under these circumstances, accumulation of the capital, technological and organisational skills essential for upgrading the economy is unlikely to materialise. Convinced that over-friendly policies towards FDI place domestic firms at a disadvantage in their own domestic market, Santipitaksakul (2010) postulated that:

situating in a lower industrial hierarchy normally means being confined to the lower profitability and technology. As a consequence, the country might find difficulties moving towards the third stage of development due to the lack of capital and technological competitiveness. (p. 115)
Aside from the neoliberal influence, the implementation of ineffective policies may also be explained by political factors, such as political instability and corruption. For example, the government budget for improving healthcare and education may be subject to corruption because the individuals involved in the project tend to seek personal benefit, instead of improving the quality of resources necessary for further development. Such behaviour is highly suspected in the case of Thailand.

According to Amsden (2007), non-strategically constructed policies aimed to attract foreign investors are the result of governments’ attempts to gain international acceptance and induce economic growth by adopting neoliberal policies, including lax policies, towards inward FDI. As the state focuses more on attracting FDI by providing locational-specific advantages for MNEs, it neglects building productive capability for domestic firms during the first and second stages of development. Moreover, overemphasis on FDI incurs other opportunity costs for internal development. For instance, tax incentives for MNEs can lower the host government’s revenue and increase the country’s dependence on international financial assistance from the World Bank or IMF. Further, it is suspected that, for Thailand, most domestic firms have difficulty accumulating capital and technology because the government has been too focused on creating an environment that highly benefits MNEs. Under these circumstances, the economy is unable to free itself from foreign capital and technology dependence, and eventually becomes a capital-dependent state that bears most of the economic characteristics portrayed by dependency theorists. As the role of the state and its policies for FDI determine the country’s developmental path, Thailand must develop a stronger state, where developmental policies favour the creation of ownership-specific advantages for domestic firms, so that the country can successfully develop the
productive capability that is important to liberate itself from dependence on foreign
capital and technology in a later stage of development.

6.5.4 Foreign investment concentration.

Kentor (2003) offered a new conceptualisation of foreign capital dependence
that may resolve this issue: foreign investment concentration. This is the proportion of a
host country’s FDI stocks owned by the single largest investing country. The theory is
that high investment concentration limits the autonomy of state and business elites to act
in the long-term interests of domestic growth. Foreign investment concentration has a
significant, long-term, negative effect on growth that is strongest over the initial five-
year period and decreases over the next 15 years. A similar effect was found for the
1990 to 1997 period. This structural aspect of capital dependence has a greater effect on
development than does the overall level of foreign capital penetration.

Foreign investment concentration is essentially the percentage of total FDI
stocks held by the top investing country. A high level of concentration threatens the
state because it allows foreign investors to control the domestic market. The power to
control the economic, political and social dynamics in a host country can override the
government’s ability to implement economic policy that favours the country’s long-term
interests.

In Thailand, when combining the share of the largest foreign investors—Japan,
the US and Hong Kong—their investment represents approximately 60 per cent of the
total FDI in 2014 (BOT, 2015). This indicates that, collectively, these major investors
would have more political and economic bargaining power than that of the Thai
government. A lack of autonomy affects the bargaining power of states in dealing and
negotiating with foreign investors in home and global markets. This generates a pattern
of dependency, where the government becomes weak and often corrupt—a problem that
this study argues may have been worsened by neoliberal globalisation policies in the 1980s.

However, foreign investment concentration is not the only indicator of the economic significance of FDI in the host economy. Past research on capital dependency used the stock of FDI to GDP as another measure of the degree of foreign capital penetration (Dixon & Boswell, 1996; Firebaugh, 1996; Kentor, 1998; Kentor & Boswell, 2003; Soysa & O'Neal, 1999). In Thailand, the significant increase in ratio of FDI to GDP from 1980 to 2009 reflects high penetration of foreign capital since the financial crisis in 1997, as seen in Figure 6.7.

![Stock of FDI to GDP](image)

*Figure 6.7. Ratio of FDI to GFP, 1980–2009. Source: UNCTAD (2010).*

This was confirmed by Santipitaksakul (2010), who found a high level of FDI concentration for Thailand when measured in terms of the percentage share of total investment by the three largest foreign investors, classified by country. Even though this concentration has recently slightly decreased, the implication remains that a few countries, collectively, may have bargaining power over the Thai government for international investment-related policies.
6.5.5 Financial system. Following the neoliberal ideology, financial reform and liberalisation has been openly pursued in Thailand based on the belief that the cause of economic instability was the structural weaknesses in the financial sector. Particularly in the wake of the AFC, Thai economic institutions were thoroughly discredited, and the soundness of the financial system and efficiency of the corporate governance system were seriously questioned. Under these circumstances, the inflow of FDI was regarded as central to successful corporate restructuring and supporting full economic recovery, especially by reducing the corporate leverage ratio and expanding the equity market, given that the prospect of new domestic funding was weakened by high political risk. However, despite its liberalisation, Thailand’s financial sector was diagnosed with several weaknesses: the large informal sector, persistent income inequality, large rural population below the poverty line, proliferation of SMEs, and high household debt to GDP ratio (Tambunlertchai, 2014). These features are somewhat common in developing countries that lack financial literacy and financial inclusion—that is, universal access to appropriate and adequate financial services.

Financial inclusion is one of the major weaknesses found in most developing and less developing countries. Past empirical studies—including recent ones by Bauchet et al. (2011) and Cull et al. (2014)—have found a positive relationship between people’s access to financial services and welfare, particularly in poorer, low-income households and in microenterprises in emerging economies. Against this backdrop, the success of a country’s financial development can, to an extent, be reflected by the level of financial inclusion. Addressing this issue in Thailand, Tambunlertchai (2015) found an existing gap in unmet demand for financial products and services, a gap in financial education provision, and an underlying weakness in the existing regulatory institution setting.

33 In general, a microenterprise is considered a small business employing 10 people or fewer, financed by microcredit.
Given the country’s sizable informal sector, high level of household debt, persistent income inequality, and huge population living in rural areas, financial inclusion is an important goal for Thailand’s development plans. Today, access to financial services is still not extended to rural and low-income households in certain areas of Thailand. Moreover, increasing household over-indebtedness, particularly for low-income households in rural areas, is very concerning, given their low financial literacy score. Existing programs that address debt prevention and management are limited. According to the BOT, household debt rose to 10.2 trillion baht (or 84.2 per cent of the GDP) in the third quarter of 2014—up from 83.5 per cent in the second quarter—and could escalate to over 90 per cent if left unaddressed. Moreover, these official figures exclude the large amount of money owed to unauthorised lenders and ‘loan sharks’, which may push the leverage ratio to be above 100 per cent. This situation may bring Thailand to the verge of collapse and cause risk a worse crisis than the 1997 AFC, with larger collateral damage.

In terms of financial management, different institutions tend to have their own sets of standards, which creates significant diversity in rules and regulations. Specifically, formal financial institutions have stringent rules, while semi-formal financial institutions are more flexible, and informal financial institutions are basically unregulated. Since the latter two are not subject to any prudential or non-prudential regulations, this non-uniformity creates an uneven playing field among different financial service providers, in which formal institutions are disadvantaged in terms of meeting the needs of low-income households and SMEs.

Based on all these findings, this study argues that there remain many weaknesses concealed behind the country’s professed financial liberalisation. Therefore, the government must address its policy issues and research ideas in order to promote
financial inclusion and financial literacy, focusing on national strategies to enable financial education, consumer protection and financial literacy for micro-entrepreneurs and SMEs.

6.5.6 TFP. One of the most discussed approaches to rebalancing growth and development is improving a country’s TFP. Fundamentally, higher productivity makes a country more competitive in the long term because it translates into higher wage rates and thus higher real income, and enhances the purchasing power of the domestic market. Empirical studies have shown that the openness of the economy has improved productivity in Thailand (e.g. Stokke, 2000; Uruta & Yokota, 1994). However, the endogenous learning process has been slower and more limited than expected. Tinakorn and Sussangkarn (1998) found that 81 per cent of Thailand’s manufacturing growth during 1981 to 1990 was due to increases in manufacturing employment and capital stock, with only 3.6 per cent due to improved quality of workers, and 15.4 per cent to TFP increases. Rattsø and Stokke (2003) found that TFP growth in Thailand has been mainly been driven by learning and imitation, while investment in R&D has played a minor role. These studies generally agreed that Thailand needs to improve its TFP and upgrade its exports into higher value-added products to remain competitive in the global market. One major challenge is the problem of weak absorptive capacity and slow technological progress, which hinder the potential development of more technologically sophisticated products. These issues have been the subject of public discourse, yet have not been suitably resolved. This again emphasises the country’s need for a higher degree of R&D, improved education system, and greater support from the government in the form of subsidies to sectors with high growth potential.

A more recent study by Santipitaksakul (2010) examined the intensity of FDI by sector in relation to TFP growth in Thailand, and considered whether the sector that
exhibited the highest TFP was where FDI was mostly clustered. Most productivity studies in Thailand have classified the economy into three major sectors: agriculture, industry and services. Of these, the sector with the highest average TFP growth rate seems to be agriculture. However, among the few studies conducted in Thailand using growth accounting data, the results vary with methods and datasets (Bosworth, 2005; Chandrachai, Bangorn & Kamjara, 2004; Sitthikul, 2001; Tinakorn & Sussangkarn, 1996, 1998). For example, the growth of average TFP in the industrial sector was found to be:

- positive by Bosworth (2005), based on data from 1977 to 2005

The variation in these findings is likely due to discrepancies in labour input measurement and variations in the weight attached to the growth rates in capital and labour, thereby affecting the degree of TFP growth rate estimated in each study. Despite these variations, it can be observed that TFP growth in the industrial sector has been found to be modest or, in many cases, negative. This contradicts the conventional perspectives that propose that the industrial sector—Thailand’s most FDI-intensive sector—to be the main driver of economic growth through foreign investment. If this is correct, it implies that FDI actually has limited contributions to TFP growth in Thailand, or that Thailand’s inward FDI has been misguidedly clustered in the wrong sector, which means that the positive spillovers from FDI have not been optimally materialised.

**6.5.7 Export dependence.** Memories of the AFC’s destabilising capital flows and weakened currencies left many East Asian countries wary of neoliberal policy, and thus became a major source of global demand for the US dollar liquidity. The causes of
the recession—such as substantial capital inflows, rising asset prices and debt-financed consumption—led Thailand and most East Asian countries to reinstate an export-led growth strategy in order to accumulate US dollar reserves, which generated the type of macroeconomic expansion that accompanies a build up of excessive US leverage and debt. In effect, this renders the wider periphery dependency and vulnerability to the domestic macroeconomic conditions of the US economy. This major flaw in the global structure was highlighted by Jitsuchon and Sussangkarn’s (2009) discussion of Thailand’s government policy responses to the GFC, which suggested that the measures implemented were mainly short term, and have not addressed the need to rebalance Thailand’s growth path to be sustainable and less dependent on the export sector in the future. Other studies have shown that the role played by the export sector was crucial for Thailand to cushion the effects of the AFC crisis on the poor. Compared to its neighbours, Thailand’s share of export of goods and services to GDP rose from an average of 38 per cent before the 1997 crisis to around 65 per cent after the crisis. Although this trend also occurred among other crisis-hit countries, Thailand’s increased dependence on exports was more pronounced, with the exception of extremely open economies, such as Malaysia and Singapore.

Thailand’s overreliance on exports was largely induced by the belief that engaging in exporting activities can promote firms’ productivity. While there is no general consensus regarding this, due to limited empirical evidence, a recent study by Cheewatrakoolpong and Potipiti (2014) showed that, in Thailand, linkage productivity spillovers exist, but are only created when exporting to developed countries. Moreover, it found that backward linkages are the most important spillover channel for exporting firms, while non-exporters gain productivity through forward linkages via supplying goods to exporting firms. Thus, the study supported the theory that engaging in
international production networks promotes the productivity of firms via linkage spillovers, and justified the RTG’s export focus.

In pursuit of higher export growth, Thailand’s much-needed capital was obtained through the government’s promotion of FDI. Since Thailand undoubtedly has a natural comparative advantage in food- and tourism-related sectors, local businesses lack the technological capability to compete effectively with MNEs. Thus, Thailand has essentially relied on attracting FDI to develop various parts of the high-tech sector. For example, the automotive industry has been relatively successful with this strategy. Looking back, the decline in domestic investment from its peak before the AFC and continuous FDI inflow to Thailand reflects the investments that have driven the high-tech export sector. Thus, it was inevitable that the growth prospects of the Thai economy would become dependent on prospects for growth and trade at the global and regional level.

The issue of Thailand being highly dependent on external trade was discussed over a decade ago; however, the recent subprime crisis renewed academic interest in and criticism of Thai development policies and their vulnerabilities to crises. According to Jitsuchon and Sussangkarn (2009), both theory and the experience of developing countries indicate that cash transfers are among the most effective ways to stimulate the economy and mitigate the negative effects of crises on the poor and other exposed groups. However, the study found that the programs implemented by the Thai government in response to the 2008 GFC failed to meet this expectation. For example, under the Social Security System, living-expenses subsidies were made available to private employees who earn below 15,000 baht per month. However, this was unlikely to go to the very poor, who account for around 10 per cent of the total population, because most very poor people work in the informal industries or in agriculture, and are
not part of the Social Security System. Moreover, while various tax incentives have been designed to stimulate investments in response to the GFC, some sector-specific tax incentives—such as those for the real estate sector—are unlikely to be effective before the general economy recovers.

In terms of monetary policy, the common response by most countries was monetary easing, including Thailand. However, due to the nature of the subprime crisis, the main cause of the problem for these crisis-hit countries was largely from declining import orders from overseas; thus, lowering financial costs was unlikely to offer much help to their economies. One important debate regarding monetary policy is exchange rate management. Particularly for an export-led economy such as Thailand, problems arise for the export sector, and exporters demand to be supported through a weaker exchange rate in order to stay competitive with other countries in the region, such as South Korea, Indonesia and India, who all weakened their currencies in response to the subprime crisis. However, this signals a danger for all countries in the region because such a policy trend can lead the region into an episode of competitive currency devaluation, which benefits no one. Moreover, once financial situations begin to stabilise, interest rates will likely increase as most countries around the world need to borrow in order to finance their fiscal injections. This can become a major impediment to growth for a sustained period, as evident from the debt crisis experienced by many countries after the second oil shock. Accordingly, if growth recovery relies too heavily on fiscal injections over an extended period, it can lead to massive public debt accumulation, which has been a major concern for Thailand. Thus, the ongoing effects of the GFC should not be underestimated. Policymakers seem to believe that the crisis will be short lived, as reflected in their short-term policy responses driven by the need to defend the economy against the economic contraction. During this recovery, it is
unlikely that East Asian exports will regain the major roles in East Asian economies that they held prior to the crisis. In essence, Thailand needs to restructure its economy so it can pursue a new growth path that is less dependent on exports, before the sustainability of fiscal injections becomes a major issue.

Unlike during the 1997 AFC, when Thailand was able to export its way into recovery, supported by currency depreciation, the 2008 GFC told a different story. Not only were East Asian countries faced with competitive currency devaluation, but their exports were also no longer absorbed by advanced economies. As the main powerhouses slow down, it is crucial for export-dependent economies, such as Thailand, to rethink their development strategies in order to create a more secure growth path that does not leave the country vulnerable to external imbalances. However, correcting such deep-rooted imbalance requires the economy to undergo substantial restructuring, involving shifts in international trade. For example, there is a general consensus among economists worldwide that the US needs to import less and export more, while East Asian economies that are trading with the US must do the opposite. However, this will involve genuine adjustment across the board, not simply altering figures in a database. Changes in microeconomic policies are also needed to help workers shift to new economic sectors, which usually require varying skills. Another challenge in correcting global imbalances is realigning major currencies. Despite a general agreement that the US dollar needs to be much weaker against its major trade partners’ currencies, this is not an easy decision to make for all economies involved. In particular, East Asian countries must consider the trade-off between the high risk of the re-emergence of massive global imbalances that would severely hurt their economies, and losing the substantial value of the US dollar–denominated assets held by the region. However, this proposal to readjust development strategies in the short to medium term does mean that
exports are no longer important to East Asian countries. Rather, these countries need to rely less on export by supplementing it with other factors based on domestic demand. Again, this needs prudent supervision and administration in order to avoid the reoccurrence of economic bubbles and current account deficits, as Thailand experienced leading to the 1997 AFC.

The 2008 GFC highlighted Thailand’s export dependency, and further emphasised the importance of increasing domestic activities to support global demand and secure uninterrupted growth. However, Thailand’s limitations are governed by its growth model and degree of co-dependency with US monetary power via its preference towards the dollar. Overall, FDI has been the major channel of Thailand’s export growth, while the decreasing share of domestic consumption accounts for the country’s export dependency. Hence, it can be argued that Thailand’s development has been undermined by its inability to address that long-term dependency on external demand, which has somewhat ensured US hegemony. This unbalanced situation continues to be bolstered by Thailand’s macro policy regime, which favours an exchange rate policy geared towards export-led growth.

6.5.8 Import dependence. One of the structural weaknesses of Thailand’s overreliance on exports is largely due to the high import content for its leading exports. Thailand’s import structure for 2009 to 2013 is depicted in the following table, which indicates that more than half of the total imports in 2013 were raw materials (37.9 per cent) and capital goods (26.2 per cent), while consumer goods comprised only nine per cent.

| Thailand’s Import Structure (2009–2013) |  |
The export-led FDI strategy that Thailand has pursued has brought significant benefits. However, most production inputs are imported from overseas to ensure that the end products are of sufficient quality to compete in the export market. This is reflected in Thailand’s import ranking, with the top five imports being for crude oil, industrial use machines, electrical machinery and parts, chemicals, and electronic integrated circuits. This quality control cut off the desired linkages; thus, local producers have not really benefited from MNEs’ productions. The increase in share of imported capital in the total imports of goods and services indicates that both international and domestic companies tend to use imported capital goods more than domestically produced capital goods. Thus, in addition to its reliance on exports, Thailand’s economic growth is also dependent on its integration in the world market in yet another channel (Reinhardt,
Jitsuchon and Sussangkarn (2009) proposed reducing the import content of various sector in the economy in order to increase domestic demand and rebalance Thailand’s economic growth. This does not suggest reversing the IS regime, but rather involves a government measure that encourages a deeper and more diversified production base. Another challenge is for Thailand to encourage more technology transfer from MNEs to local firms so that local firms supply MNEs with inputs for production. However, this is not easy to achieve because Thailand is characterised by import dependence, and, as local supply industries remain inferior, demand for imported inputs remains relatively inelastic. This indicates that, in the long term, export competitiveness cannot be easily restored through currency devaluation because overreliance on imported inputs weakens this effect. Although Thailand has a large pool of unskilled labour available for assembly operations, this is not a basis for long-term industry competitiveness because of the continuing threat posed by other low-wage competitors, such as China and Vietnam.

6.5.9 Primary versus non-primary export development. Industrialisation and agriculture have long been recognised as key policy priorities for many developing countries. However, this is a complex issue for both are important and interlinked but the actual practices are generally conflicted (such as land use and investing). In an ideal scenario, growth in agriculture leads to higher productivity and capital intensity, which distributes labour to higher value-added activities in urban centres, where industry and services develop. Ultimately, this increases income for the state to enable further development. Thus, agriculture becomes a tax revenue source until the industry and urban centres develop, and then developed countries start subsidising agriculture. Unfortunately, this process is not guaranteed, especially if productivity growth is export-oriented instead of development-oriented. Countries such as Thailand fall into
the former category, as evident in the lack of necessary infrastructure, education and services in cities to absorb the enormous influx of urban inhabitants and enable the creation of high value-added sectors. In the worse scenario, the movement of people to cities is fuelled by poverty in rural areas, as well as erosion and land degradation, which lead to negative developments on all sides.

Particularly for resource-rich countries, agriculture is often a driver of initial investment, while industrialisation is more central to high-end development. Thus, appropriate sequencing is necessary to manage the transition from an agrarian to developed urbanised economy. To ensure this, prioritisation is key. For developing countries, food sufficiency is important because it relieves pressure on the import budget. In this respect, agriculture should not be compromised, but supported with contemporary techniques and logistics to boost the productivity and income of the rural population. Meanwhile, urbanisation should not be abandoned because it ideally enhances people’s wellbeing. Preferably, the state should intervene in the fields of education, healthcare and other social issues in order to strike a balance between rural and urban areas.

In the academic literature, evidence has been found that indicates that the growth effects of FDI tend to vary distinctively across resource-rich developing countries. The previous literature pointed to many potential determinants of the FDI–growth relationship, including economic development (Blomstrom et al., 1994), trade openness (Balasubramanyam et al., 1996), human capital (Borensztein et al., 1998), local financial market development (Alfaro et al., 2004) and institutional and political environment (Herzer et al., 2008, 2012). However, it was recently proposed that another determinant of the FDI–growth relationship is primary export dependence (Jitsuchon, 2002; Reinhardt, 2000). A general concern in many resource-rich countries is that a
large share of FDI goes to the primary sector, which shifts the economy away from competitive manufacturing sectors, which purportedly have higher degrees of linkages and spillover effects into the rest of the economy. In order to escape this ‘resource curse’ effect, Thailand shifted its focus from traditional agriculture to labour-intensive manufacturing in the late 1970s, and successfully achieved above-average GDP growth for more than three decades, with an increase in non-resource-based exports, such as electronics. However, critics argue that this rapid growth has become less favourable to long-term development in the past decade. For example, Thailand’s electronic boom has tightened the markets for labour, transportation and less variable domestic inputs, thereby generating negative externalities for other exports. Thus, if new export industries generated less positive externalities than anticipated, natural resources may play a larger role than previously suggested.

Before industrialisation, agriculture growth in Thailand during the 1960s and 1970s was attributed to access to vacant land and the huge available labour force. After Thailand decided to pursue industrialisation in the 1980s, exports were taxed in order to keep domestic prices low and raise government revenue for public investment in other areas. Consequently, labourers relocated to various growing sectors of the economy, while the agriculture sector became less labour intensive and more industrialised. The result was that agriculture continued to grow at 2.2 per cent between 1983 and 2007, but only provided half of all rural jobs, as farmers took advantage of the government investment to diversify (Leturque & Wiggins, 2010). It is evident that, with rising industrialisation, Thailand’s agriculture declined in relative financial importance in terms of income. Panagariya (2003) stated that agriculture liberalisation does not necessarily benefit farmers in developing countries. Instead, it tends to benefit middle-income groups, who have a strong comparative advantage in agriculture. Another study
by Reinhardt (2000) emphasised the greater importance of the *character* of growth, rather than the *speed* of growth, for long-term development prospects. Reinhardt argued that the growth of resource-based manufactures may offer as much long-term development potential as the labour-intensive manufactures that have dominated the government’s attention for the past decade. This has important implications for export-oriented FDI and public policy related to resource-based export sectors.

In terms of FDI, past studies have shown mixed results. Although MNE operations in Thailand are largely located in export sectors and account for more than 60 per cent of total exports, the spillovers from MNEs to Thai local firms are not sufficiently supported by empirical studies. As MNEs are mostly capital intensive, the concern is that, if FDI is concentrated in sectors that do not exhibit positive externalities, other sectors that have higher potential may shrink and lose productivity in the long term. If this is proven to be the case, Thailand should not overlook its natural advantages as a resource-rich country, nor underestimate the effect of resource wealth on policy formation and industrial real wages from primary activities. Against this backdrop, improvement in Thailand’s public policy supporting resource-based export sectors is highly recommended. Additionally, trade liberalisation must be accompanied by strategic planning and effective government foreign policies, otherwise the introduction of superior MNEs to the domestic markets will amplify market imperfections, and domestic investors may have difficulty developing their ownership-specific advantages. Reduction in local productive capacity and unfavourable interruption of the country’s development path have resulted from the above traits of dependency, as indicated by the unfavourable position of Thailand in relation to the rest of the world.

**6.6 Conclusion**
Frequent changes in political regimes have accentuated power disputes in the political setting of Thailand, and contributed to domestic political instability. This instability has become deeply ingrained in the economy over time, as evidenced by the number of military coups and rebellions throughout the history of Thailand. As anticipated, each political event resulted in great economic fluctuation. In this context, the interplay between politics and economics has clearly affected the country’s development path. From this assessment of Thailand’s recent economic and political events, this study found that the country’s present situation is vulnerable to external shocks and internal stress as political turmoil continues to overshadow the economy, and result in loss of competitiveness.

This chapter’s discussion has highlighted Thailand’s structural weaknesses in the context of the political economy of international trade and finance. It has suggested that, despite Thailand’s liberalisation and open encouragement of FDI, the country’s economic development is still largely disrupted by many factors. Not only is the economy suffering from significant overcapacities and many structural constraints—such a shortage of skilled labour and lack of investment in R&D—but there are also pressing problems of high household debt, slowing manufacturing activities, lower agriculture prices and falling exports. Of particular concern, this qualitative analysis revealed a capital-dependent type of development, which exacerbates the challenges faced by the Thai government regarding future development in the midst of slowing global demand and shifts in global trade.

The structural weaknesses determined in this chapter must be resolved with appropriate and well-considered policies that are specifically designed to manage internal issues, while safeguarding against external ones. Importantly, FDI policies must be designed in conjunction with other development policies. The types of FDI that
should be encouraged are those with extended benefits that are nationwide, improve the skills of the local workforce, and ultimately help reduce the income inequality gap. Overall, government policies are critical for determining the direction and consequential effects of FDI. The following concluding chapter provides appropriate suggestions to address this.
Chapter 7: Policy Recommendations and Conclusion

7.1 Introduction

Thailand is at an important economic crossroads. The Thai economy’s uneven growth has been generally blamed on external or non-economic factors, such as the 2008 GFC, 2011 major flood and a decade of ongoing political flux. However, these temporary factors cannot mask the underlying causes of Thailand’s falling growth potential. This thesis recognises that the Thai economy’s fundamental structural strength and capacity to grow has declined during recent years. The threats of falling global demand, rising competition from ASEAN countries, higher cost of borrowing and extremely high household debt will likely weaken the factors that have previously driven Thailand’s economic growth, and further expose the country’s fundamental weaknesses. Thus, sustainable development is unlikely to occur unless appropriate measures are taken to ensure prudent management of government policy.

Today, the concept of FDI appears on many countries’ policy agendas. While substantial literature has developed on how FDI affects host countries, a wide range of empirical results appear in the academic literature with little to no sign of convergence. This ambiguity demonstrates that developmental gains from investment are not always automatic. Nevertheless, FDI has high potential to benefit developing countries in terms of providing much-needed capital, foreign exchange, and technical skills and knowledge. In addition, FDI can be a great contributor to the country’s infrastructure development, which is essential for further stimulating economic activities and attracting more foreign investors. Based on this line of thought, Thailand has openly pursued FDI and relied on it heavily to restore economic growth after the 1997 AFC. However, over time, Thailand has begun showing signs of overreliance that may become detrimental to the domestic economy and create adverse effects on the
country’s long-term development. This chapter draws a number of helpful conclusions, and presents some policy implications and recommendations.

7.2 Findings and Lessons Learnt

The most explicit conclusion from this study’s literature review is that the full potential of FDI has not been realised in Thailand. Despite receiving billions of dollars of FDI, the effect of FDI on the Thai economy in terms of growth and employment appears uneven between sectors. The results from this study’s empirical analysis indicated that the most significant effect is on the tourism industry, which is positively related to FDI. A negative, yet insignificant, result was found for the agriculture sector, while positive, yet insignificant, results were found for the other sectors, such as electricity and utilities, manufacturing and finance.

These results confirm this study’s initial observation that the effects of FDI on Thailand vary between economic sectors, and are generally unexploited. Given Thailand’s current stage of development, creating a stronger economic foundation that enhances spillover effects should be more important to the government than simply distributing FDI incentives that may prioritise quantity over quality. However, the outputs of FDI are often assessed by quantitative results (such as GDP and exports generated by FDI) rather than qualitative effects (such as long-term changes in the HDI, poverty, income inequality and social welfare). In addition, little attention has been paid to the extensible effects of FDI in terms of linkages between foreign and domestic firms. One could argue that Thailand’s FDI policy has tended to be determined in a reactive manner, rather than designed to strengthen national competitiveness. As a result, the country is missing the linkages that are essential for the economy to develop more quickly through knowledge and skills transfer, and technological capacity building.
This indicates the need to actively enhance the broader effects of foreign investors—otherwise, little developmental progress will be gained from closer collaboration with MNEs. To date, the RTG’s efforts to strengthen investment promotion activities and make them more proactive as tools of competitiveness have been relatively extensive, but not well coordinated or monitored, and are often interrupted by political disorder and change of governments. Importantly, lack of spillover from international firms indicates how Thailand’s structural weaknesses are undermining the benefits of FDI. This study’s qualitative analysis confirmed that, while the Thai economy has been hurt by problems such as global crises and natural disasters, the real factors that prevent the economy from progressing are institutional and structural weaknesses, such as:

- uneven development between urban and rural areas
- income inequality
- the ageing society
- the middle-income trap
- low absorptive capacity
- the backward educational system
- missing UILs
- unsupported innovation
- low R&D and S&T
- financial exclusion
- weak law and order
- lack of government support
- narrow focus on low-skilled production and services
- dependent state development
• overreliance on exports
• falling international competitiveness
• political diversity.

These structural weaknesses have long been recognised, yet never properly addressed due to political turmoil and constant interference from vested interests. Corruption and coups are chronic problems that prevent the government from implementing development policies and improving the aspects of the economy that are crucial for FDI, such as building infrastructure and human capacity. During the changes of government in recent years, policies could not be properly implemented, budgets were constricted, and former governments’ projects—including major infrastructure plans (high-speed train and water management)—were inevitably postponed.

Uncertainty prevented the economy from fully recovering as the immediate effects affected consumer and investor confidence. Potential investors became cautious, with some postponing their investment and others redirecting their projects to other FDI destinations. Despite the lack of clear empirical evidence, it is evident that political instability has curbed Thailand’s economic growth in many ways.

With regard to human resource development, it is clear that Thailand has poor quality and unequal access to education. This is the root of Thailand’s low labour quality, which hinders the country’s gross FDI inflow and economic growth. Not only is the educational system flawed, but there is also a concerning problem of a large skill mismatch between the skills offered by local workers and the skills required by foreign firms, as reflected in the growing informal sector. A policy designed to create strategic alliances between education and economic sectors—such as UILs that involve bidirectional flow of information and technology—would help reduce this skill mismatch and enhance the research and knowledge suitable for sectoral development.
Such a human resource development program could be successful with government’s funding and expenditure on education to help build up knowledge and disseminate technology, as seen in Singapore, which has managed to attract higher FDI than other countries in the region. In Thailand, the government must strengthen fundamental development to generate the same effect. The lack of coordination and centralisation issues between the organisations involved in human resource development (such as the Ministry of Education and Ministry of Science and Technology) and the insufficient infrastructure must be addressed in order to achieve progress in this regard.

Many areas urgently need policy revisions. While some can be improved with minor adjustments, other may require an outright system overhaul. For some sectors, the government may simply have to lift restrictions in order for FDI to be effective and beneficial; however, for other sectors, the spillover effects need to be enhanced. Thus, FDI policy recommendations must be sector specific. For example, this study’s results show that the effects of FDI are positive, but not very strong in either manufacturing or agriculture. The agriculture sector receives insufficient FDI inflow due to the government’s restrictions, while the manufacturing sector receives a significant amount of FDI due to the government’s promotion, but is not generating the potential spillover effects due to the lack of human capacity and technological readiness. Falling productivity in the Thai agricultural sector reflects a labour shortage problem, as farm hands are drawn towards the better-paid manufacturing and services sectors, while those who remain are ageing workers with incomes that are below the national average. However, these two sectors can improve and prosper together if productivity is enhanced. To achieve this, policymakers need to encourage better mechanisation that can increase productivity gains and transfer new skills and knowledge to existing rural
farming communities. This means less use of price controls and market interventions, and increased use of new technology and contemporary farming methods.

In addition to the need for a stronger education focus and modernisation to raise farmers’ incomes through productivity gains, the government must also consider other issues that appear to be deterring growth, such as the controversial low-yield, higher-quality rice production that has worsened agriculturists’ income, and the scattered land ownership and low percentage of irrigable land that limits efficient economies of scale and lessens farmers’ opportunities to diversify into more profitable crops. All these problems highlight the government’s need to formulate better assistance programs, commit to more R&D for new farming methods, provide more accessible financial aid for low-income agrarians, and support knowledge transfer and attainment of new technologies among local farmers. This process could also be accelerated by reducing the restrictions on FDI in the agricultural sector.

In the wake of the 1997 AFC, Thailand’s experience demonstrated the need for caution in the process of liberalisation, especially in the financial sector. Unless liberalisation is carefully arranged with protection measures, it risks causing major issues in terms of growth and development. Prior to liberalising its capital accounts, a country must have a good financial safety net that include a sound domestic financial system, prudential regulations, and a policy framework and instruments to deal with excessive capital inflows and sudden outflows.

The development of the Thai financial market has made some improvements in reducing poverty, but disparities remain in terms of accessing the full range of financial services. Evidence has shown that less than half of Thailand’s low-income households have access to finance and borrowing services, and less than three quarters have access to savings products. Recent figures from the ADB (2012) indicated that 80 per cent of
Thailand’s middle- to high-income families have accessed three or more financial services, while only 38 per cent of low-income families have accessed minimum financial services, and 16 per cent of low-income families have never accessed financial services. Financial risk management is lacking in all levels of the economy due to individuals’ weak grasp of basic financial concepts and knowledge of problematic financial decision making. Predominant financial attitudes indicate an over-inclination to focus on the present, rather than on future planning. Lack of financial literacy and financial inclusion indicate that Thailand’s financial liberalisation is only partially successful.

Moreover, Thailand faces pressing issues from high and increasing household debt and unequal credit access. The difficulty of accessing finances is the largest obstacle for SMEs, whose contribution to the GDP has been increasing since the 1997 AFC and is now playing a crucial role in the Thai economy, constituting more than two thirds of employment and over 99 per cent of registered firms. In addition, there remain many households with prospective entrepreneurs who cannot gain credit due to their limited wealth. This indicates the possibility that even a small improvement in Thailand’s financial sector could lead to significant growth in the business sector, and thus a significant increase in GDP. Despite all its promising benefits, promoting FSFDI alone is insufficient to strengthen the financial sector. The government must first address the fundamental weaknesses arising from lack of financial literacy and financial inclusion.

At the same time, the government must build trust in formal financial institutions to meet the growing and unmet demands, especially from the larger low-
income group, in order to prevent them from turning to informal institutions. Financial education programs should highlight the risks and consequences of over-indebtedness, provide open access to impartial information for underprivileged and unbanked people, and extend the scope of consumer protection for all. Other service innovations, such as mobile banking, could also be explored to cover unbanked and underserved segments. Although Thailand shows clear compliance with international financial sector standards and protocols, its current framework is weakened by the lack of legal independence and ineffective reinforcement. These problems have long been identified, yet improvement has been excruciatingly slow, especially in matters that require government action. This calls for proper legal reforms in Thailand’s financial sector to allow the BOT to freely regulate, supervise and take action when required, without the influences of other political institutions.

Overall, Thailand is not benefiting from FDI because the existing FDI does not generate sufficient spillover effects to enable sustainable growth. In this context, general development policies are as important as FDI-focused policies in terms of encouraging investment in sectors in which Thailand has comparative advantages—namely, agriculture, food processing, small-scale manufacturing and tourism. While extensive research has shown that FDI has certain benefits, the government must refrain from implementing over-generous FDI promotion schemes, such as tax incentives based on the microeconomic advantages of hosting FDI. This is because these schemes can adversely lead to substantial opportunity cost at a macroeconomic level. Instead, the government should consider the following recommendations in order to foster linkages and enhance the longer-term benefits of FDI.

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34 Informal financial institutions are non-bank and local moneylenders that provide easy access to finance. However, this privilege comes at a higher price that leads to higher household debt, as often seen in the case of loan products in urban areas, which cater to low-income individuals and microenterprises.
7.3 Points to Consider for Future Policy Formulation

Based on this study’s outcomes, the Thai government should consider implementing the following policy recommendations:

1. broaden access to education, particularly for low-income households
2. improve the national curriculum and teaching assessment systems to raise education standards and meet future demands for skilled labour
3. strengthen lifelong learning to increase labour market flexibility
4. improve agricultural productivity through education, modernisation and better use of technology in farming
5. improve transport infrastructure between agricultural production sites and urban areas
6. improve utilities and speed up rural development
7. upgrade tourism-specific infrastructure
8. upgrade the hotel and restaurant sector to grow and diversify beyond mass low-cost tourism
9. improve the prudential and supervisory framework for the financial sector
10. ease credit access and provide affordable financial advices
11. restructure financial services regulations to promote financial inclusion and alleviate household debt
12. raise SME productivity through well-coordinated assistance programs
13. improve fiscal efficiency through institutional reform.

In summary, policy revision is essential for future development considerations. Policymakers should address all social and economic losses that may arise from certain conditions of their investment plans. Most importantly, there must be transparency and
consistency during policy implementation, and reliable supervision to uphold investors’ confidence throughout political turbulence.

7.4 Thesis Contributions and Future Research Opportunities

Although numerous studies have examined the relation between FDI inflows and GDP, the majority of this work includes GDP merely as an explanatory variable in the FDI determinant function. A relatively small number of studies have focused specifically on the effects of FDI inflows on the host country’s growth and development, and most were conducted at an aggregate level. However, as the behaviours of foreign investors change in tandem with globalisation, the contemporary focus is being narrowed to country- and sector-specific analysis, where well-defined governance, accommodating infrastructure and sound government policies are crucial for FDI development.

The contribution of this thesis is threefold. The major focuses were:

1. quantitative analysis: FDI determinants in Thailand
2. quantitative analysis: FDI’s effects on different sectors’ growth
3. qualitative analysis: the political economy of FDI in Thailand.

The results from these analyses contribute to the international trade and finance literature through a country-specific case study of FDI experiences and development prospects. The analysis focused specifically on Thailand, yet has important policy implications for other developing countries with similar socio-political economic settings. Ultimately, this thesis aimed to provide a direction for future policy formation and implementation through better understanding of the strengths and weaknesses of FDI in a particular political economy setting. The findings should be used to improve Thailand’s investment and industrial policies in order to sustain, and hopefully upgrade, the country’s development and ranking in the global economy. Academically, the
findings of this study should also be used to enhance the knowledge base of FDI studies in Thailand.

7.4.1 Suggestions for future research. Based on the scope of this research, this empirical analysis has made a suitable contribution to the study of FDI and economic development by presenting current empirical evidence and outlining policy implications for Thailand. However, due to the limited scope of study, some areas were left unexplored. By outlining these limitations, future work can be suggested.

First, the diagnostic test was based on the exogenous FDI–growth model, which is constrained by neoclassical assumptions. Thus, the model excluded the political aspects of the economy and the role of institutions. As Thailand’s political impasse is far from over, its real political effects may not be fully evident at present. Thus, future analysis is recommended. For studies dedicated to understanding FDI determinants, an extension to existing models is advised. Aside from political factors, researchers should also consider including independent variables, such as business facilities, capital market development, investment climate, special privileges for foreign investors, environmental regulations, governance of host and home countries, and regional integration. While these factors tend to have data and measurement issues, appropriate proxies can be used to obtain effective results and provide more robust policy inferences.

To further advance this, future studies should be concerned with issues pertaining to determining the optimum size and location for FDI, considering overall development plans, as well as the expected flow of capital to and from foreign markets. This is essential for ensuring that FDI policy minimises access difficulties for MNEs and maximises spillover effects in related industries. Such studies can feed into the development planning process for the economy by improving important market facilities, such as ensuring adequate car parking space, storage, and communication and
banking facilities, and ensuring that these plans allow future expansion of the domestic market and related infrastructure.

Second, this study’s sectoral analysis encompassed large economic sectors, yet excluded smaller sectors, such as education, health and health services, where the level of FDI inflow is too minimal for feasible results. Although these areas are less targeted for FDI and it is inherently difficult to measure progress in these areas due to lack of data, they are considered vital for sustainable development of the economy and should be the top priority for government policies. Important research opportunities are conditional on accessing reliable data, which are somewhat limited at the sectoral level. Likewise, where data are available, it will be interesting to expand the sectoral analysis of FDI to host and home countries in neighbouring ASEAN countries, such as Malaysia or Vietnam, to explore competition in the region.

Third, improvements can be made via more consistent data estimation. This study found that the available data varied depending on the data measurement, data provider and time of data collection. Discrepancies also occurred because figures reported by the RTG differ to those reported by the IMF in its BOP statistics. For example, Thailand has several definitions of the service sector, depending on the agency collecting the data, which can be for different purposes. This creates complexities for researchers and analysts. In order to revise the system, the government must collect data both horizontally and vertically, and at both regional and provincial levels. A revision of data collection methods should be as detailed as possible to ensure data comparability to that of other countries. Additionally, while the informal sector comprises a significant part of the Thai economy, it is not included in any official estimates. Thus, this study recommends that service activities—such as personal taxis, street vending and private tutoring—be collected and included for better reflection of the real economy. Although
these data shortcomings are not serious enough to invalidate all empirical findings, data quality is vital for effective R&D; thus, a degree of caution must be exercised when interpreting this study’s results. Again, improved national data collection and measurement standards will enhance future research opportunities, and validate research outcomes.

Fourth, TFDI is difficult to determine because the taxonomy of tourism activities is unclear. The tourism industry is largely perceived by locals as being open and easy to enter, and providing vast opportunities for everyone. Thus, it results in the significant growth of informal activities in the industry. Informal activities are not included in the government’s estimates; therefore, TFDI risks are underestimated and its effect on the economy may be questionable. Future studies must be improved by including a better definition of tourism and tourism-related activities, which will allow researchers to create a more accurate indicator of TFDI that fully complies with the international standard for measuring FDI, as supported by the IMF, OECD and UNCTAD.

Finally, the specific structure of ownership and form of management chosen by foreign investors is critical and depends on prevailing political, sociocultural and economic factors. Therefore, considerations of business and legal issues will help identify the type of FDI and operating structure that are most conducive to the existing institutional setting. Analysts are urged to further consider how these issues are related to political events in order to understand their effects on investment behaviours. To ensure that the outcome of such studies feeds into the policy and planning process, there must be a crossing point between researchers and other stakeholders, especially political leaders and bureaucrats. It is important to ensure that results from studies are as comprehensive as possible in order to facilitate decision making on policy implementation for future FDI projects.
7.5 Conclusions

International trade and financial liberalisation in the global economy present both increasing opportunities and challenges for economies worldwide, and recent trends portray FDI as a key driver for economic growth, particularly for developing countries. This has resulted in governments implementing investment promotions and policies designed to increase national competitiveness and attract greater FDI. However, recent studies are moving beyond simply determining the drivers of FDI. Researchers recognise that the quality of FDI is equally important, if not more important, than the quantity of FDI, which may or may not be sustainable in the long term. Thus, it has become increasingly important to evaluate the effects of FDI on real economic growth.

This study found that Thailand has a great deal of potential, yet the speed of development does not match this potential, which indicates that growth opportunities have been missed. Faced with increasing constraints on the labour market and falling productivity growth, Thailand urgently needs to implement economic reforms. While it is important to boost capital investment, FDI promotion without due consideration of its effects can impose higher costs on the economy. For example, growth has not been fully inclusive because its gains have not been widely shared. Most concerning is the high and growing inequalities in the region, both in terms of incomes and opportunities, as well the disparities between different geographic locations and social positions, such as rural and urban areas, and women and men. In this case, FDI may have aggravated the problem of uneven development and income inequality in Thailand, given that FDI is located in urban areas, while rural areas remain largely underdeveloped. Therefore, when liberalising trade and investments, efforts must be made to strengthen local firms against increasing competition in the market, and reposition the country’s manufacturing sector to focus on areas of competitive advantage.
Finally, while many other factors typically affect growth, government intervention and policy implementation is undoubtedly one of the major causes of Thailand’s uneven economic growth. In many ways, the lack of political fortitude, coupled with weak institutions and imprudent policies, has led to Thailand’s current predicament. Thailand’s deep-rooted political conflict and constant turnover of short-lived governments have undeniably obstructed the progress of economic development. Given the rapidly changing global economic context, uncertainties in developed economies and increasing competition in ASEAN, Thailand risks huge opportunity and future losses if it does not re-establish political stability and implement economic reforms. Solving all problems at once may be impossible; however, the starting point must be addressing the political issues and restoring consumer and investor confidence—after all, policies are ineffective if they cannot be implemented.
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Appendix

Thailand’s International Competitiveness in the Global Economy

Country assessment and comparison. Ensuring a country’s competitiveness is widely accepted as the most important way of sustaining prosperity and increasing citizens’ wellbeing. However, competitiveness is not a static or lasting quality. Remaining competitive requires constant economic upgrading and transformation. In some cases, changing national settings and international relationships can create an environment in which factors employed to create competitiveness in the past may become destructive in the future. For example, Thailand once successfully emerged and rose above its competitors; however, it is now encountering difficulty in maintaining its position, and appears to have reached a bottleneck in moving to the next stage of development. Therefore, the ability of a country to learn and adapt to a new global environment and create complementary factors is essential to maintain its position in today’s globally competitive market.

Enhancing competitiveness is a long-term process that requires improvement in many areas and long-lasting commitment from all sectors of the economy, especially the government and investors. However, to effectively measure a country’s economic development, one must analyse beyond the simple growth rate. This is because quantitative measures such as GNP do not reflect qualitative changes, such as improved technological production or enhanced human skills. Therefore, economic development needs to be carefully assessed from all perspectives in today’s global setting.

It is important to note that ‘competitiveness’ is a relative, not absolute, concept. Thus, its definition can vary, depending on the context and level of discussion. Cho and Moon (1998) considered the sources of countries’ economic development and international competitiveness from three different perspectives: physical factors, human
factors and the government. They constructed the following table to demonstrate the relationship between different stages of economic development and sources of international competitiveness, with examples from the Asian region.

Table A.1

*Development Stages and Sources of International Competitiveness*

<table>
<thead>
<tr>
<th></th>
<th>Less developed stage</th>
<th>Developing stage</th>
<th>Semi-developed stage</th>
<th>Developed stage</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Physical factor</strong></td>
<td>Natural resources</td>
<td>Basic infrastructure</td>
<td>Clustering</td>
<td>Advanced infrastructure</td>
</tr>
<tr>
<td><strong>Human factor</strong></td>
<td>Non-trained workers</td>
<td>Trained workers</td>
<td>Entrepreneurs</td>
<td>Professionals</td>
</tr>
<tr>
<td><strong>Government</strong></td>
<td>Inbound FDI Open-door</td>
<td>Exporting Learning</td>
<td>Outbound FDI S&amp;T industry</td>
<td>World-class fair R-dist</td>
</tr>
<tr>
<td><strong>Examples</strong></td>
<td>India Bangladesh Nepal</td>
<td>Malaysia Thailand</td>
<td>Singapore Hong Kong Korea</td>
<td>Japan</td>
</tr>
</tbody>
</table>


It is concerning that, more than a decade after Cho and Moon’s (1998) study, Thailand remains in the developing stage, marked by increasing GDP per capita and workers being trained to produce labour-intensive products in mature industries, with technologies passed on by MNEs. The sources of international competitiveness in this stage are basic infrastructure, such as roads, ports, financial markets and other socioeconomic environments—in all of which Thailand is performing less successfully than many other Asian countries.

Despite minor divergences between the most internationally recognised competitiveness rankings of nations (the World Competitiveness Yearbook by the IMD, Competitiveness Report by the WEF, Ease of Doing Business Index by the World Bank and IEF by the Heritage Foundation and Wall Street Journal), it is generally agreed that
Thailand has competitive advantages in the areas of cost competitiveness, a skilled workforce, openness and a business-friendly environment. In particular, Thailand has outperformed most countries in international trade, employment, fiscal policy and labour market, but has been outperformed in business legislation, social framework, productivity and efficiency, technical infrastructure, education, health and environment (IMD, 2014). According to the IMD report, the major weaknesses that prevent Thailand from ranking higher exist in innovation, political governance and intellectual property laws.

*Figure A.1.* Thailand’s competitive landscape. Source: IMD World Competitiveness Report (2014).

Other weaknesses lie in the poor quality of health, education, technology and national institutions. Progress in S&T is a great concern, particularly because technological readiness has drastically dropped during the past few years. Investment in R&D also remains low for Thailand in all competitiveness indexes. Looking back, what Thailand lacks in R&D, S&T infrastructure and innovation were temporarily set aside by high FDI and low-cost competition. However, Thailand’s competitiveness is gradually declining since other neighbouring competitors have entered the arena. This is
reflected in the following figure, which compares the growth rates of ASEAN countries during the past decade.

![Figure A.2. ASEAN countries’ GDP growth constant price, 1998–Q3/2013 (year over year, per cent). Source: IMF and CEIC (2013).]

While economic growth in key economies in the region has been lower than expected, Thailand has clearly underperformed compared to other ASEAN members, since it appeared to be the only country with a significant downward trend of GDP growth in 2013. Significantly, FDI- and export-led growth is likely to become less significant in the future without the benefit of Generalised System of Preferences privileges with the European Union. Since Thailand was upgraded to an upper-middle-income country by the World Bank, it is no longer eligible for these privileges. Based on this, a foreseeable change is that Thai exports will lose competitiveness to countries that still receive these privileges, such as India, Vietnam, Indonesia and the Philippines;
to countries that benefit from FTAs with the European Union, such as Malaysia; or simply to more competitive countries, such as China. According to economists at the World Bank, Thailand will remain the slowest-growing economy in Southeast Asia until 2016, while its neighbours will surpass Thailand with higher estimated growth—such as Myanmar at eight per cent; Cambodia and Laos PDR at seven per cent; and Indonesia, Malaysia and Vietnam at between five and six per cent (World Bank, 2014).

In the ASEAN region, Thailand is behind Malaysia in business efficiency and infrastructure, behind Singapore in education, and behind Vietnam in labour and productivity growth. This suggests future threats that will accompany the opportunities created by the AEC formation. As the global economic power shifts to the Asian region and alters the competition platform through free flow of resources, as well as through creating a larger and more complicated market, there will also be inevitable change in the social system and interaction, which will require human adaptation in cultural diversity. Failure to adapt may create social problems related to labour, public health and crime.

Vulnerable in its position, Thailand must be mindful of emerging rivals, especially Vietnam, which, despite ranking as the fourth-competitive nation in ASEAN, has the highest gross domestic investment, growth in ICT capital service, GDP growth, labour force to GDP ratio, and industry growth (GCR, 2014). This indicates that Vietnam has been more effective in its economic development than has Thailand in the past decade. Deloitte’s 2013 Global Manufacturing Competitiveness Index evaluated 38 countries based on the global industry leaders’ perceptions of their relative competitiveness. According to this, the majority expect Vietnam and Indonesia to outperform Thailand and Malaysia in the coming years, as shown in the table below.
Table A.2

*Deloitte’s Global Manufacturing Competitiveness Index—2013 Rankings*

<table>
<thead>
<tr>
<th>2013 Rank</th>
<th>Country</th>
<th>Expected 2018 Rank</th>
<th>Expected change in rank</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>China</td>
<td>1</td>
<td>0</td>
</tr>
<tr>
<td>2</td>
<td>Germany</td>
<td>4</td>
<td>-2</td>
</tr>
<tr>
<td>3</td>
<td>USA</td>
<td>5</td>
<td>-2</td>
</tr>
<tr>
<td>4</td>
<td>India</td>
<td>2</td>
<td>+2</td>
</tr>
<tr>
<td>5</td>
<td>South Korea</td>
<td>6</td>
<td>-1</td>
</tr>
<tr>
<td>6</td>
<td>Taiwan</td>
<td>7</td>
<td>-1</td>
</tr>
<tr>
<td>7</td>
<td>Canada</td>
<td>8</td>
<td>-1</td>
</tr>
<tr>
<td>8</td>
<td>Brazil</td>
<td>3</td>
<td>+5</td>
</tr>
<tr>
<td>9</td>
<td>Singapore</td>
<td>9</td>
<td>0</td>
</tr>
<tr>
<td>10</td>
<td>Japan</td>
<td>12</td>
<td>-2</td>
</tr>
<tr>
<td>11</td>
<td>Thailand</td>
<td>15</td>
<td>-4</td>
</tr>
<tr>
<td>12</td>
<td>Mexico</td>
<td>13</td>
<td>-1</td>
</tr>
<tr>
<td>13</td>
<td>Malaysia</td>
<td>14</td>
<td>-1</td>
</tr>
<tr>
<td>14</td>
<td>Poland</td>
<td>18</td>
<td>-4</td>
</tr>
<tr>
<td>15</td>
<td>UK</td>
<td>19</td>
<td>-4</td>
</tr>
<tr>
<td>16</td>
<td>Australia</td>
<td>17</td>
<td>-1</td>
</tr>
<tr>
<td>17</td>
<td>Indonesia</td>
<td>11</td>
<td>+6</td>
</tr>
<tr>
<td>18</td>
<td>Vietnam</td>
<td>10</td>
<td>+8</td>
</tr>
<tr>
<td>19</td>
<td>Czech Republic</td>
<td>22</td>
<td>-3</td>
</tr>
<tr>
<td>20</td>
<td>Turkey</td>
<td>16</td>
<td>+4</td>
</tr>
</tbody>
</table>


Indonesia’s and Vietnam’s large pools of increasingly skilled labour and domestic markets’ vast potential for consumption-driven growth appeal to the global industry, despite their common lack of talent for advanced manufacturing; high-quality physical infrastructure; or government investment in healthcare, education and innovation. Many manufacturers are shifting production from China to these countries, as apparent in Vietnam’s rapidly expanding electronics industry (Knowler, 2015). Vietnam has become one of Thailand’s potential competitors due to its increasing economic liberalisation, strategic location, political stability (socialist), strict law, and hardworking and diligent citizens. In contrast, Thailand is expected to lose advantages for manufacturing, largely due to the country’s unresolved political issues.
In terms of FDI, which significantly reflects the competitiveness of a country, Vietnam has recorded very strong growth—almost tripling its FDI in 2013, from US$5.34 billion in 2012 to US$15.31 billion in 2013 (fDi Report, 2014). This indicates that its open-market policies have become increasingly effective in creating closer integration with the global market, and attracting international investors. Again, Thailand has fallen behind with a lower market share, as shown in the table below.

Table A.3

<table>
<thead>
<tr>
<th>Country</th>
<th>Market Share</th>
</tr>
</thead>
<tbody>
<tr>
<td>China</td>
<td>34.73%</td>
</tr>
<tr>
<td>India</td>
<td>8.57%</td>
</tr>
<tr>
<td>Vietnam</td>
<td>8.29%</td>
</tr>
<tr>
<td>Myanmar</td>
<td>7.16%</td>
</tr>
<tr>
<td>Indonesia</td>
<td>5.21%</td>
</tr>
<tr>
<td>Australia</td>
<td>5.01%</td>
</tr>
<tr>
<td>Japan</td>
<td>4.83%</td>
</tr>
<tr>
<td>Singapore</td>
<td>4.07%</td>
</tr>
<tr>
<td>Malaysia</td>
<td>2.80%</td>
</tr>
<tr>
<td>Thailand</td>
<td>2.78%</td>
</tr>
<tr>
<td>Other</td>
<td>16.55%</td>
</tr>
<tr>
<td>Total</td>
<td>100%</td>
</tr>
</tbody>
</table>


The new global economy’s effect on Thailand is that national competitiveness will become more and more important. A healthy economy requires balanced growth in all sectors. Through its long list of weaknesses, Thailand has opportunities to meet the challenges of the future. However, this is conditional on full collaboration from stakeholders across all segments of the society and economy because competitiveness must be a national goal, not a political one.